

Tax Year 2000



April, 2002
Research

W&I Research Group 5

Research Project Objectives

- Answer the eleven baseline questions relating to the four major *e-file* market segments and
- To investigate and present new data available in the four-year relational database of TY 1997, 1998, 1999 and 2000 returns (PY 1998, 1999, 2000 and 2001)



Research Questions for TY 2000

1. What are the differences in the taxpayer profiles for the four market segments and the population?
2. What are the differences in the profiles of taxpayers using each filing method based on specified measures?
3. Profile the self-prepared, simple return taxpayer by form type and other specified measures.
4. What are the repeat rates and inter-modal migration rates for paper, ELF, TeleFile and On-Line returns between TY 1999 and TY 2000?
5. Analyze loyal ELF and On-Line users who return to paper filing.

Research Questions for TY 2000 (Continued)

6. What is the number and percentage of computer usage for return preparation in each of the market segments. Analyze by specified measures.
7. Identify those taxpayers who filed a 1040PC return in TY 1999. Determine how these taxpayers filed in TY 2000.
8. Analyze first-time filers by market segments based on method of filing and method of preparation. Also, analyze them by specified measures.
9. Profile those taxpayers who received a TeleFile PIN based on eligibility and specified measures.
10. Using the multi-year ETA database, analyze how taxpayers who used TeleFile in previous years filed in TY 2000.
11. Identify and analyze taxpayers who used the self-select PIN.

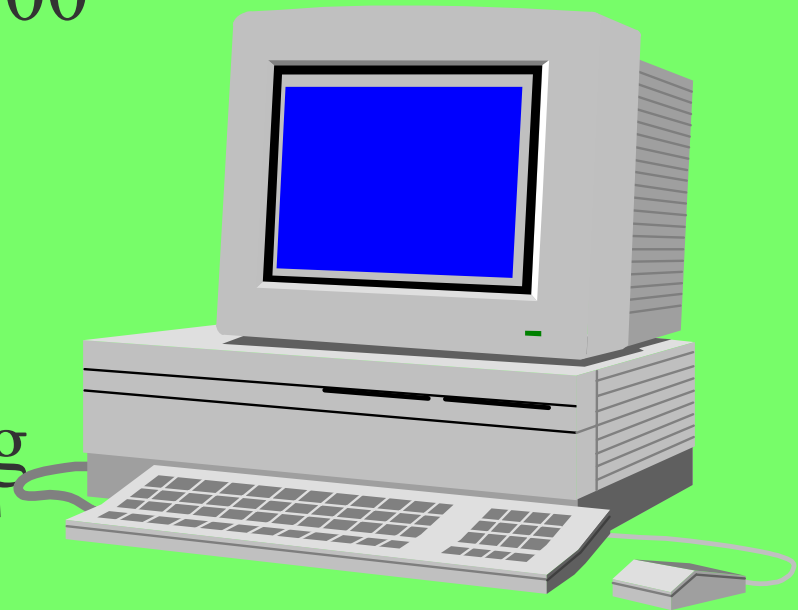
TY 2000 ETA Topics

- Market segment
- Business operating division analysis
- First time filers
- Electronic filing
- Users and non-users of electronic filing
- Four-year filer analysis
- Time-of-Filing analysis
- Computer-prepared returns and Form 1040PC migration
- TeleFile repeat analysis
- Claimed as dependent on another's return
- Self-prepared, simple filers

Primary Data Source

- All individual income tax returns filed for tax year 2000
- Processed through June 30, 2001 (cycle 200126)
- Certain variables from the TRDB and TeleFile mailing list were added to the IRTF
- Includes almost 115 million returns

PLUS



Primary Data Source (continued)

- Three more years of tax data in a relational database that includes:
- All individual income tax returns filed for tax years 1997, 1998 and 1999



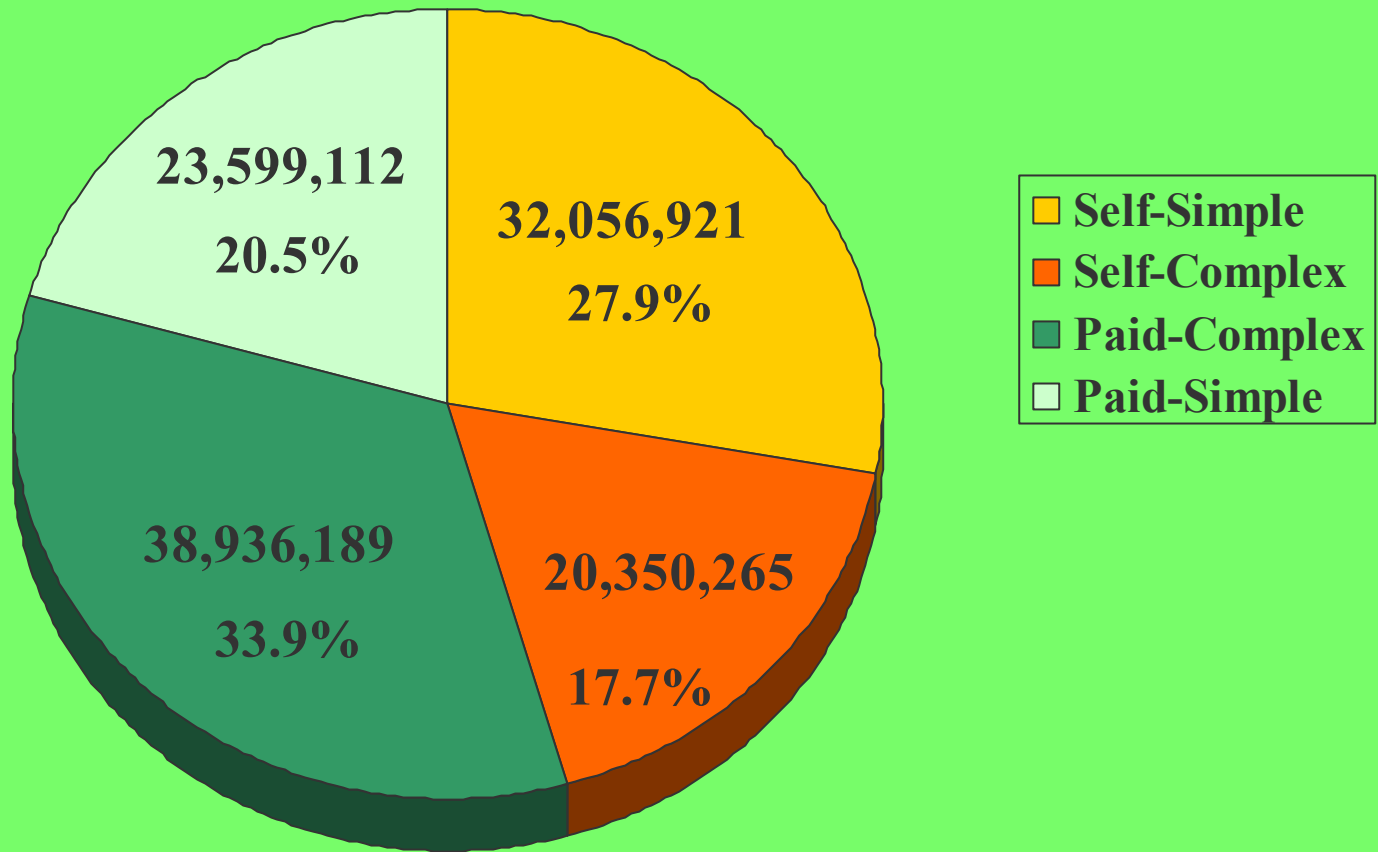
Market Segment Definitions

- Self-prepared return - there was no paid-preparer identification number on the return
- Paid-preparer return - there was a paid-preparer identification number on the return
- Simple return -
 - Form 1040-EZ or Form 1040A
 - Form 1040 with no schedules
- Complex return - all returns that do not meet the definition of a simple return

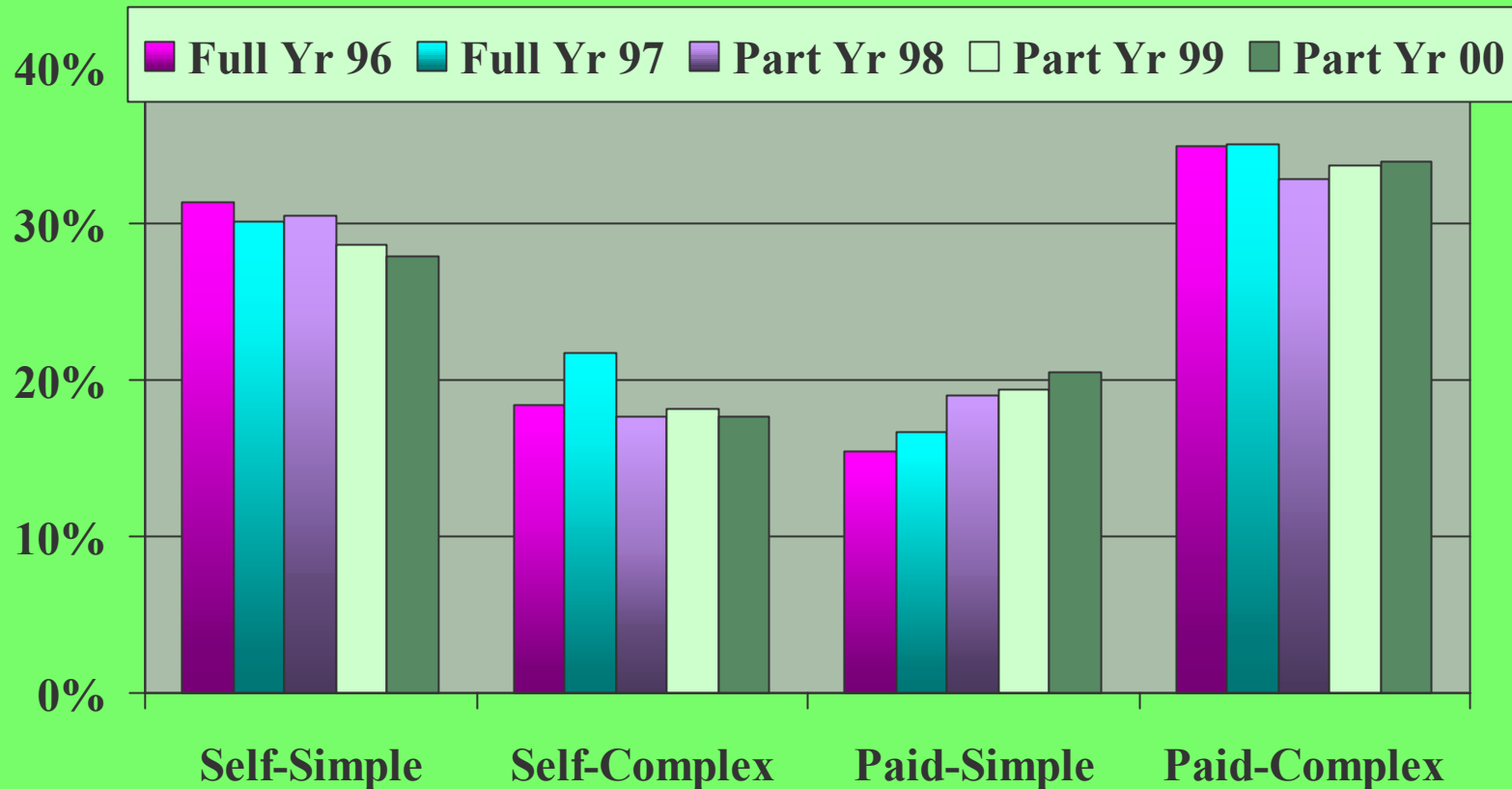
Four *e-file* Market Segments

- Self-prepared Simple Returns (Self-Simple)
- Self-prepared Complex Returns (Self-Complex)
- Paid-preparer Simple Returns (Paid-Simple)
- Paid-preparer Complex Returns (Paid-Complex)

The Four Principal Market Segments in TY 2000



There has been only a slight change in the market segment return distribution



Market Segment Profiles-Averages

| Market segment | Average primary TP age | Average adjusted gross income | Average balance due or (refund) | Average EIC amount |
|------------------------------|-------------------------------|--------------------------------------|--|---------------------------|
| Self-prepared simple | 36 years | \$20,930 | (\$678) | \$166 |
| Self-prepared complex | 44 years | \$60,405 | (\$783) | \$142 |
| Paid-preparer simple | 39 years | \$22,169 | (\$1,165) | \$472 |
| Paid-preparer complex | 47 years | \$62,751 | (\$446) | \$278 |

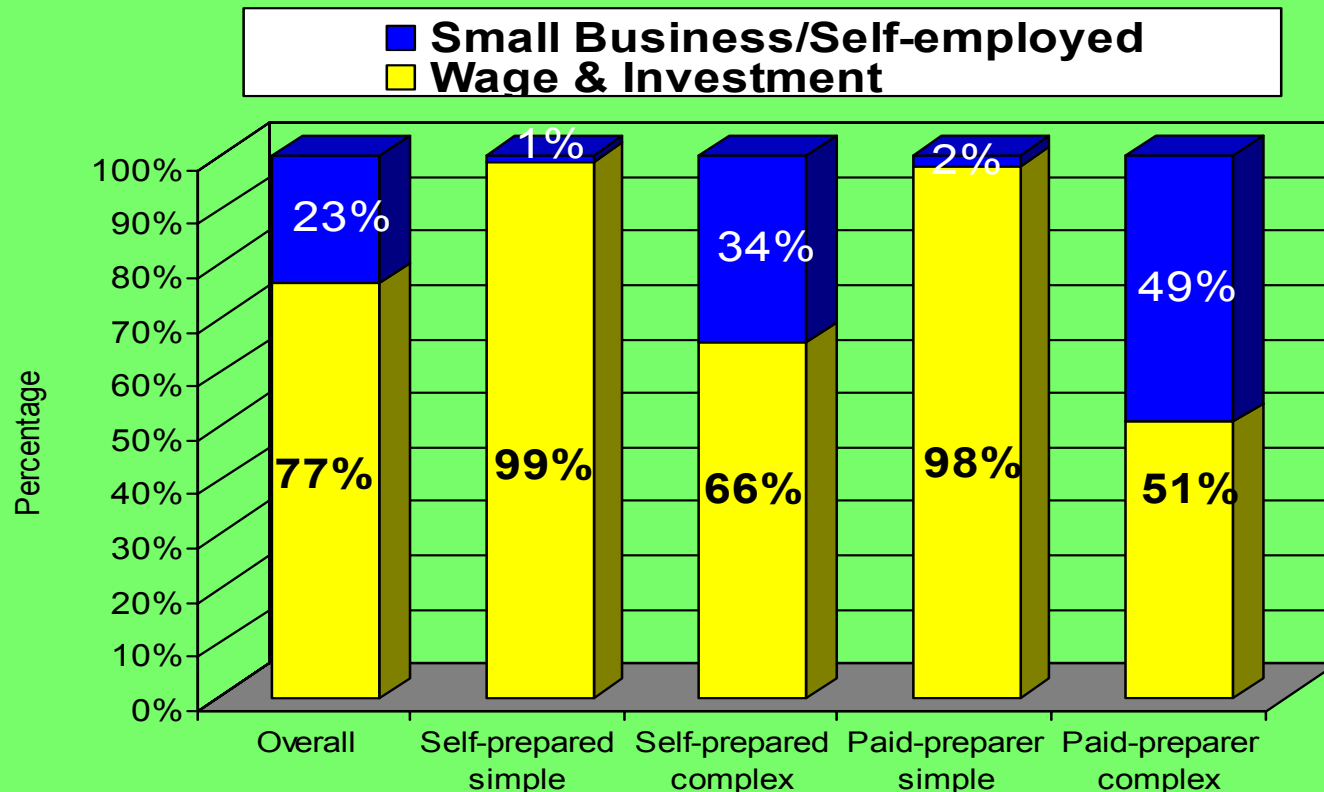
Filing Status for Market Segments

| Market segment | Single | Married, filing jointly | Married, filing separately | Head of household | Total |
|--------------------------|--------|----------------------------|-------------------------------|----------------------|-------|
| Self-prepared simple | 69.4% | 17.8% | 1.6% | 11.1% | 99.9% |
| Self-prepared complex | 32.8% | 54.7% | 2.2% | 10.1% | 99.8% |
| Paid-preparer simple | 49.2% | 25.1% | 1.5% | 24.1% | 99.9% |
| Paid-preparer complex | 30.4% | 53.5% | 1.8% | 14.2% | 99.9% |

No major differences in taxpayer profiles for the four market segments from last year, all are similar to last year

Business Operating Divisions

- 76.5% of all returns (88 million) were W&I returns.
- 98.4% of the simple market segment returns were W&I.
- Highest proportion of SB/SE returns is in paid-preparer complex return market segment.



BOD migration - TY1999 and TY2000

- 9.8% of all TY200 returns had changed BOD from TY1999.
- 4.7% of the TY2000 SBSE returns and 10.9% of the W&I returns were not matched to the TY1999 file.

TY1999 & TY2000 BOD Migration

| TY 2000 | | | Changed | | |
|---------|------------|------------|------------|------------|-------------|
| BOD | Same BOD | % of total | BOD | % of total | Total |
| SB/SE | 19,117,215 | 70.9% | 6,588,451 | 24.4% | 26,978,281 |
| W&I | 73,691,243 | 83.8% | 4,698,998 | 5.4% | 87,964,206 |
| Total | 92,808,458 | 80.8% | 11,287,449 | 9.8% | 114,942,487 |

- 24.4% of the SBSE returns had changed from W&I
- 5.4% of the W&I returns had changed from SBSE

BOD Code Data Concern

Further analysis should be conducted with caution.

There were 827,864 SBSE Simple returns (no schedules with return)

➤ 252,463 (30.5%) are PR or International,
so automatically assigned to SBSE

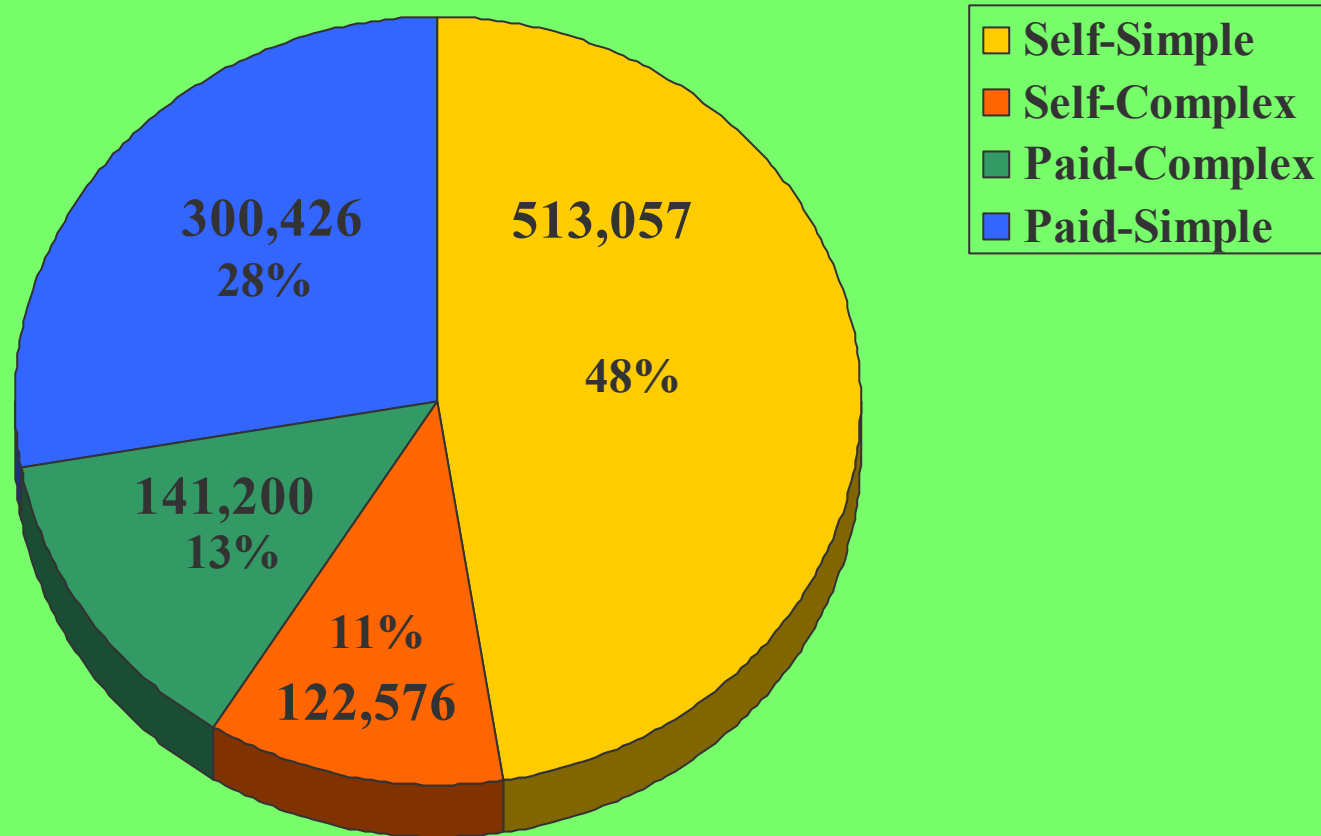
BOD Data Concerns (continued)

- Of the other 575,401 (69.5%) returns:
 - 136,810 returns were changed from W&I in TY 1999 to SB/SE in TY 2000 despite the apparent absence of any schedules.
 - 231,909 returns were assigned to SB/SE in both TY 1999 and TY 2000 despite the apparent absence of schedules in both years that would support an SBSE assignment.
 - 185,673 returns that were assigned to SBSE in both years contained at least one schedule in TY 1999 but contained no schedules in TY 2000.

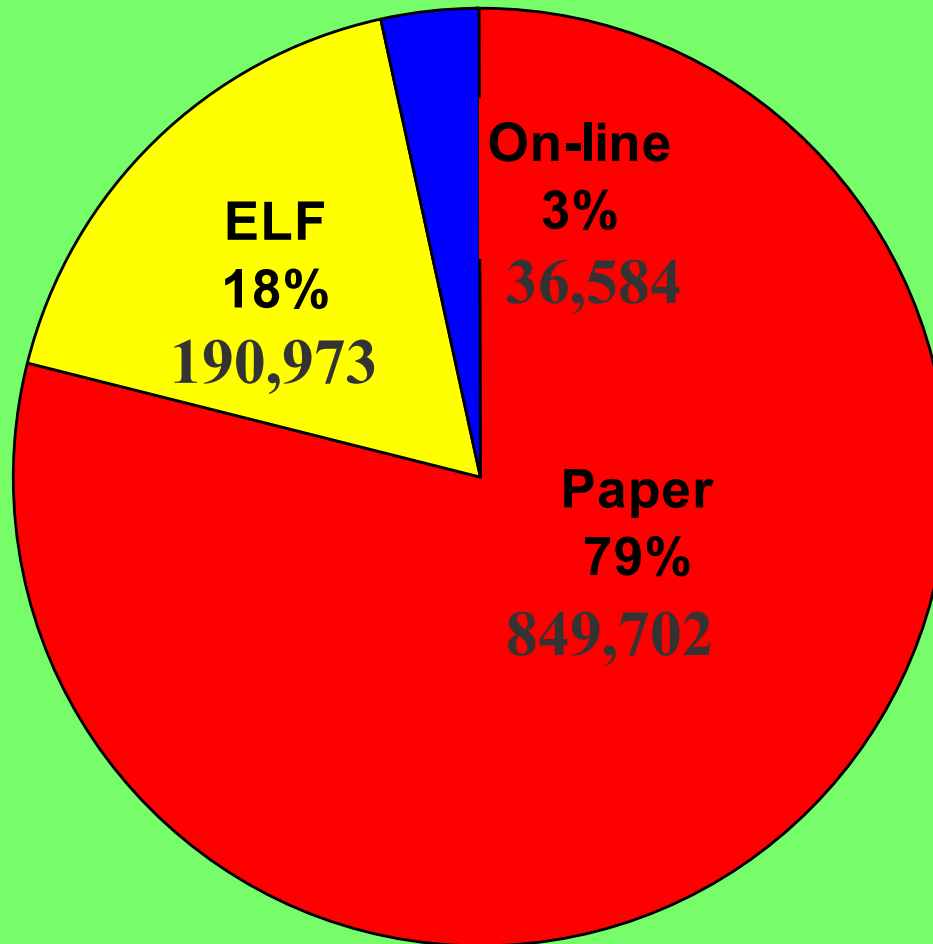
First-time Filers

- Any filer who filed in 2000 and showed no record of filing a return in 1996, 1997, 1998 or 1999 was considered a first-time filer
- Identified
 - 1,077,259 first-time filers
- Examined
 - How did they file their returns?
 - What market segment are they in?

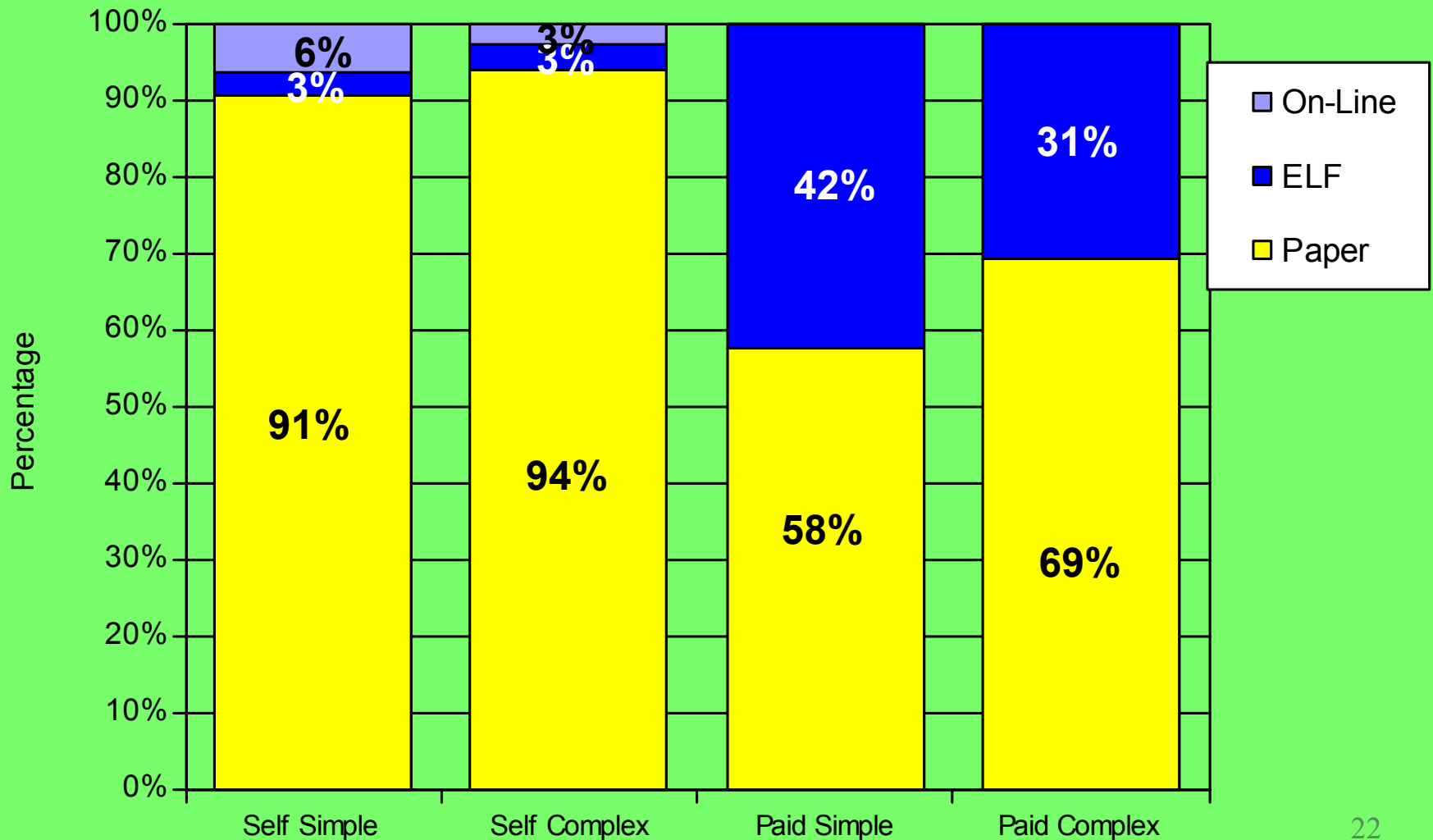
What market segment do first-time filers fall into?



How do first-time filers file?



Filing of first-time filers by market segment



First-time Filers

| <u>Balance status</u> | | <u>V-Code Status</u> | |
|----------------------------------|-----|-----------------------------|-----|
| Refund | 83% | Self Simple | 9% |
| Balance due | 12% | Self Comp | 25% |
| Even | 5% | Pd Simple | 39% |
| <u>Operating division</u> | | Pd Comp | 60% |
| W&I_____ | 87% | Overall | 26% |
| SB/SE | 13% | | |

First-Time Filers Summary

- In TY 2000, first-time filers used *e-file* for 21% of their returns
- New filers who use paid-preparers *e-file* about 39% of the time; new filers who self-prepare use *e-file* under 10% of the time
- We have no electronic product that appeals to first-time, self-prepared simple filers.

First-Time Filers Recommendations

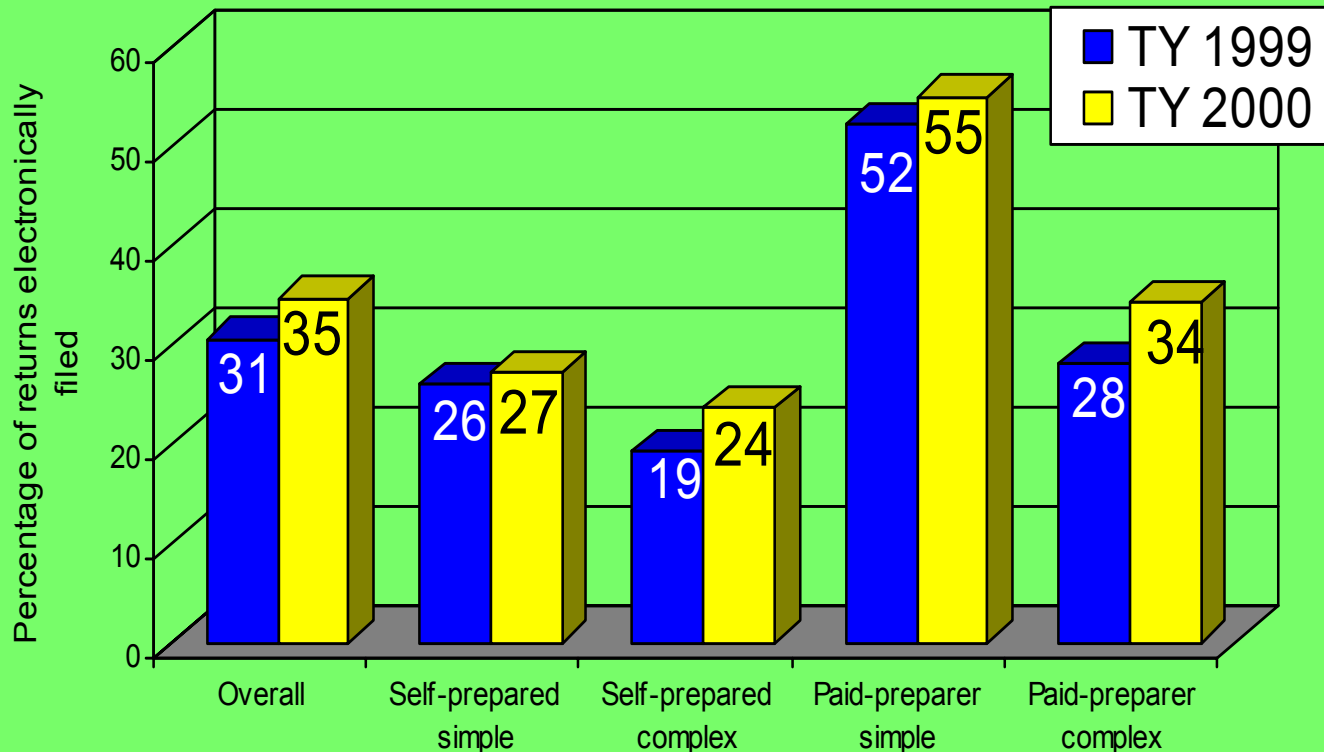
- We recommend a survey of first-time filers asking them what type of electronic product they would use if it were available
- We recommend the development of a web based companion to TeleFile that would permit first-time simple filers to file using an electronic method.

Electronic Filing in Tax Year 2000

- Electronic users vs. non-users
- Effect of time-of-filing on electronic filing

Use of electronic filing by market segment

- 35% of the TY 2000 returns were electronically filed compared to 31% of the TY 1999 returns.
- 55% of the paid-preparer simple returns are now *e-file* returns.
- The self-prepared complex return market continues to have the least *e-file* penetration (24%).



Growth in *e-file* is lagging with self-prepared simple returns:

| Market segment | TY 1999 | | | TY 2000 | | | Percent growth |
|----------------|-------------|---------------|---------|-------------|---------------|---------|----------------|
| | Returns | <i>e-file</i> | Percent | Returns | <i>e-file</i> | Percent | |
| Self-simple | 32,977,585 | 8,625,267 | 26% | 32,056,921 | 8,760,032 | 27% | 4% |
| Self-complex | 20,964,857 | 4,051,771 | 19% | 20,350,265 | 4,814,195 | 24% | 26% |
| Paid-simple | 22,280,482 | 11,622,847 | 52% | 23,599,112 | 12,976,299 | 55% | 6% |
| Paid-complex | 38,821,826, | 10,851,949 | 28% | 38,936,189, | 13,321,670 | 34% | 21% |
| Total | 115,044,750 | 35,151,834 | 31% | 114,942,487 | 39,872,196 | 35% | 13% |

Electronic Filing by Operating Division

- *e-file* returns are disproportionately represented in W&I. W&I has over 83% percent of the *e-file* returns while comprising only 77% of the filing population.
- Only 17% of the *e-filed* returns are in SB/SE.

| | Wage and Investment | Small Business/Self-employed | Total populations |
|---------------------------------|---------------------|------------------------------|--------------------|
| <i>e-file</i> Population | 33,260,533 | 6,611,663 | 39,872,196 |
| Percentage | 83% | 17% | 100% |
| Total population | 87,964,206 | 26,978,281 | 114,942,487 |
| Percentage | 77% | 23% | 100% |

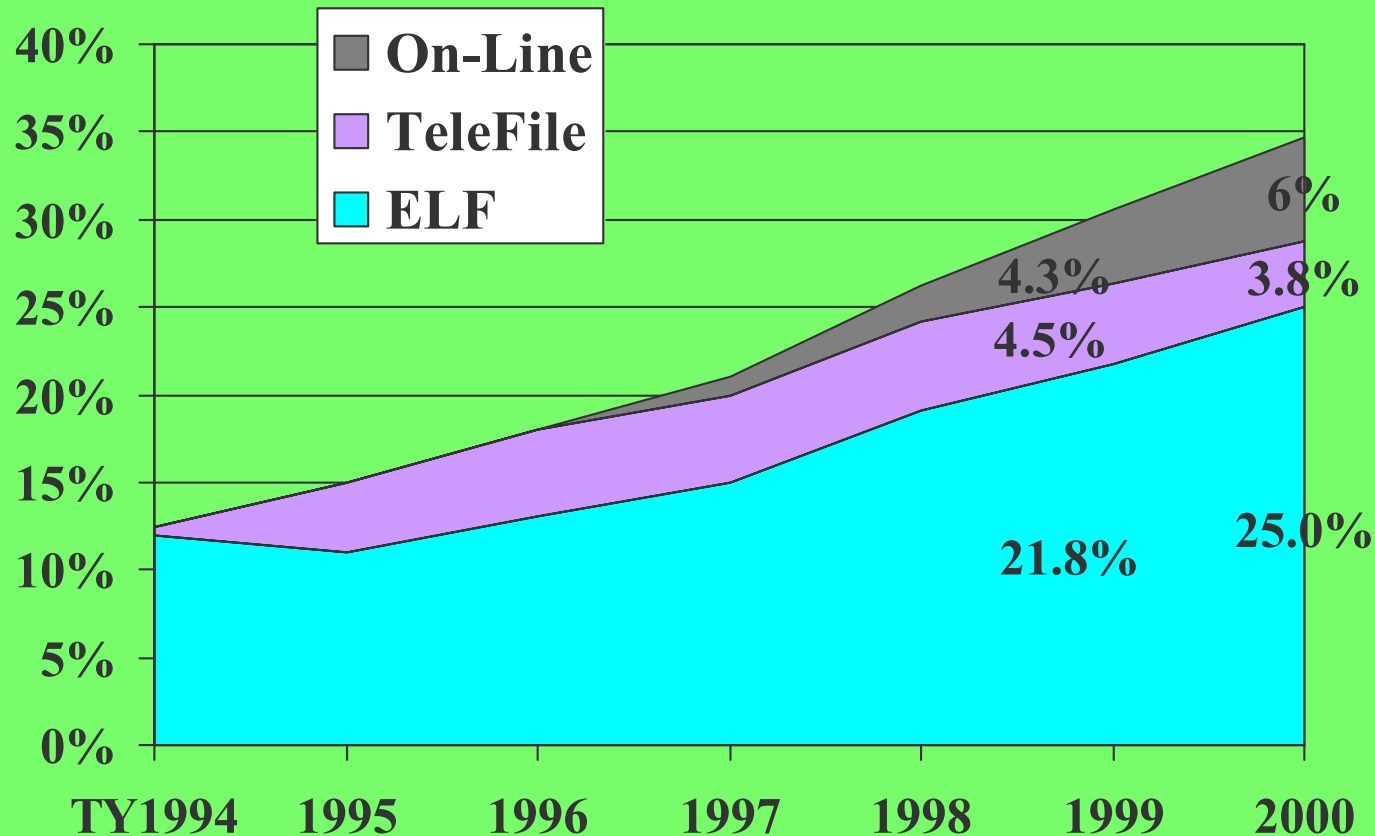
The *e-file* penetration rate increased to 35%

| | TY 1998 | TY 1999 | TY 2000 | Percentage change TY 1998 to TY 1999 | Percentage change PY 1999 to PY 2000 |
|-------------------------------|-------------|-------------|-------------|--|--|
| Electronic returns | 26% | 31% | 35% | 20% | 13% |
| • ELF | 19% | 22% | 25% | 18% | 15% |
| • TeleFile | 5% | 5% | 4% | -9% | -14% |
| • On-Line | 2% | 4% | 6% | 122% | 36% |
| Paper returns | 74% | 69% | 65% | -9% | -6% |
| Total returns | 100% | 100% | 100% | - | - |

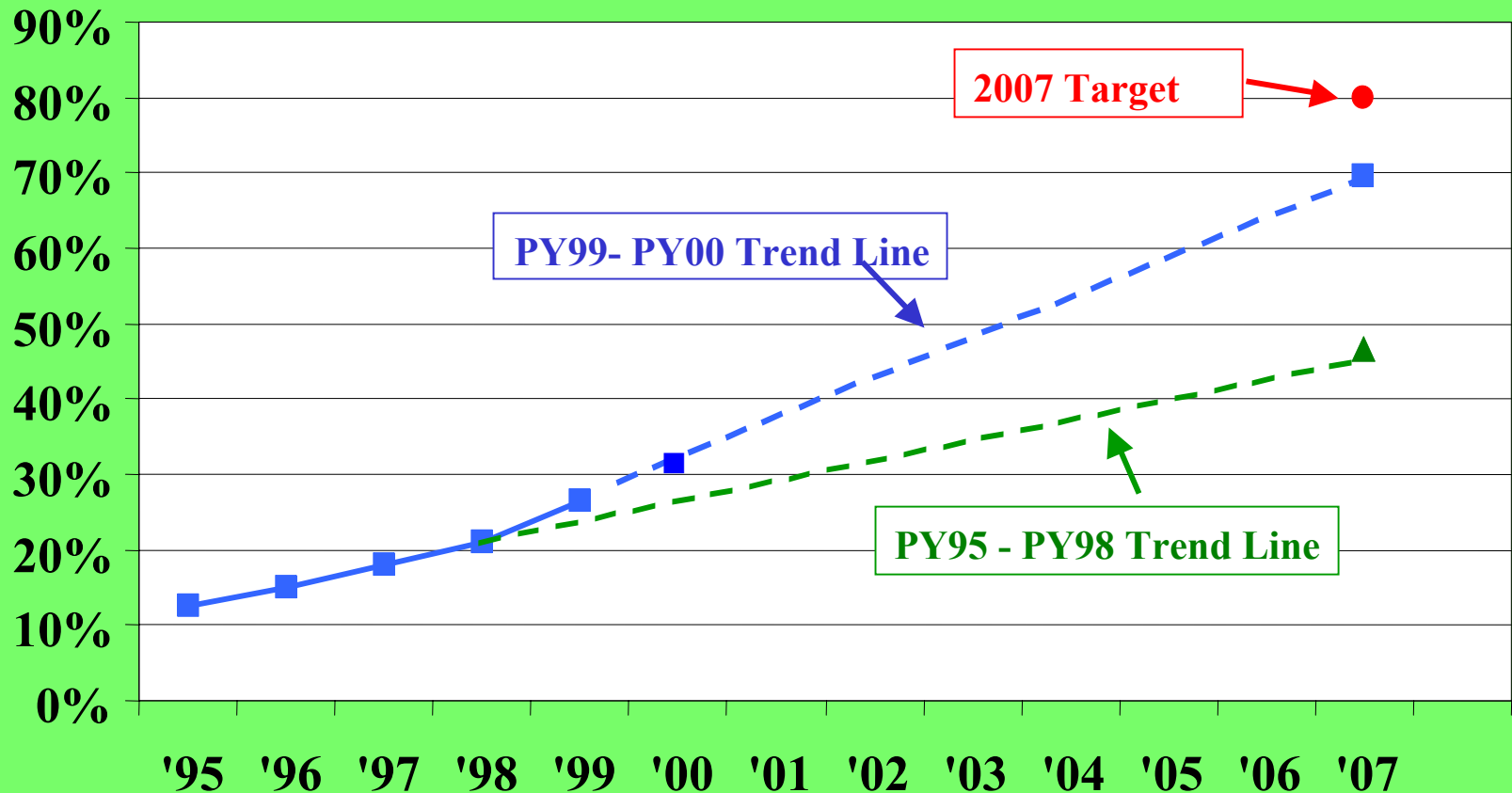
On-Line filing continued to show growth

TeleFile accelerated its loss of users

The filing trend is toward electronic returns

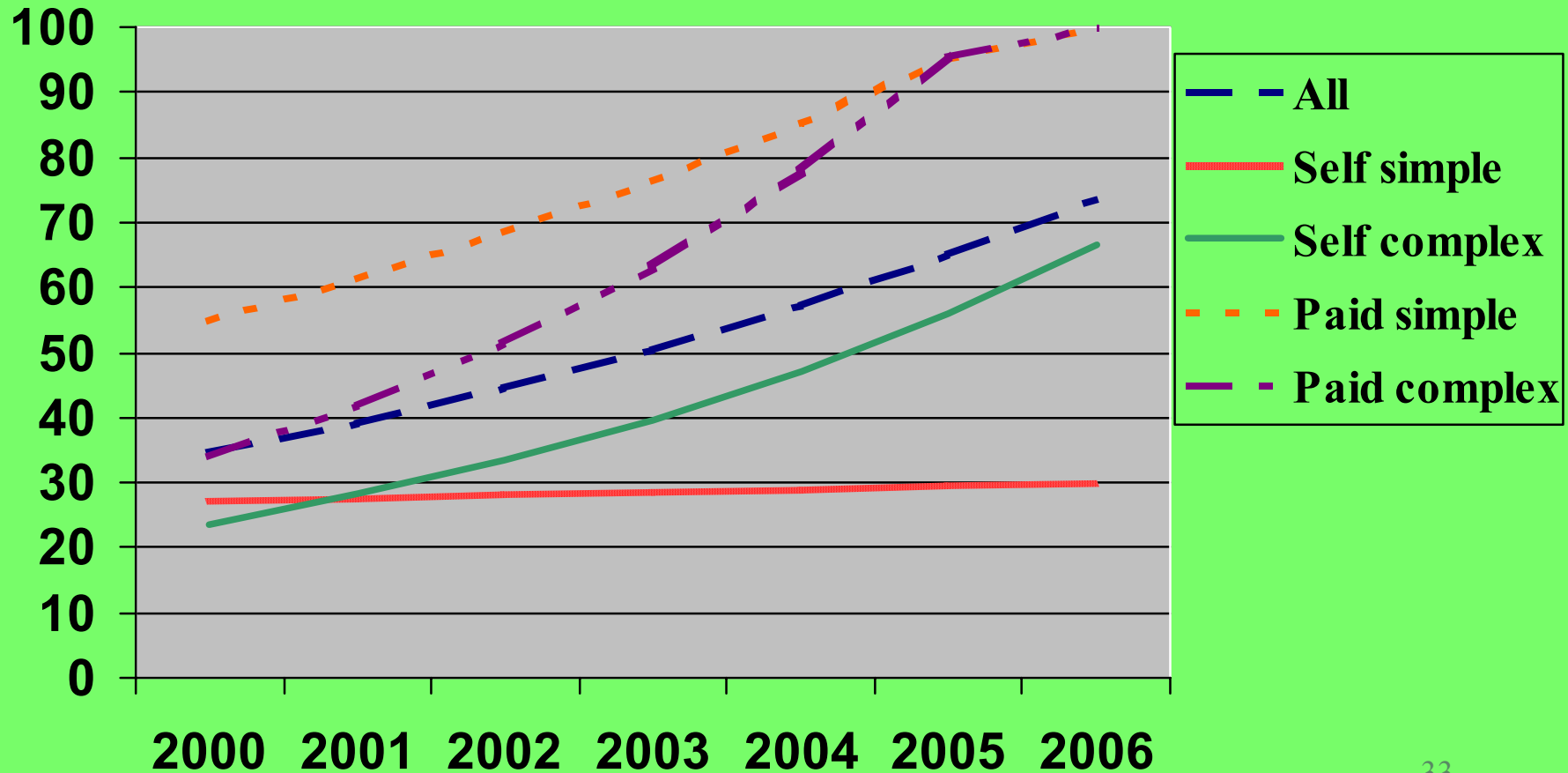


The *e-file* penetration growth rate increased significantly in TY 2000

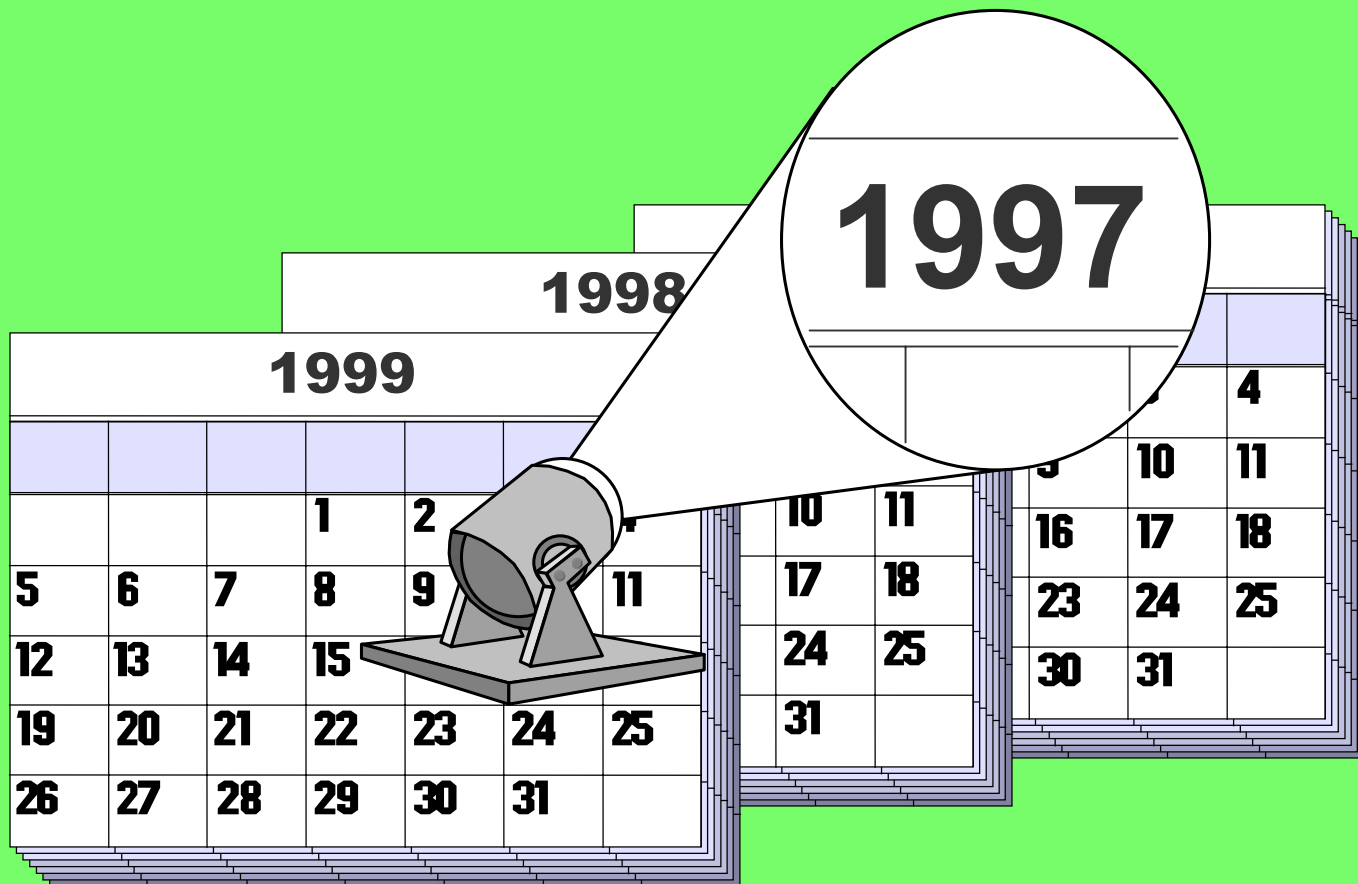


But is still insufficient to meet the 2007 target.

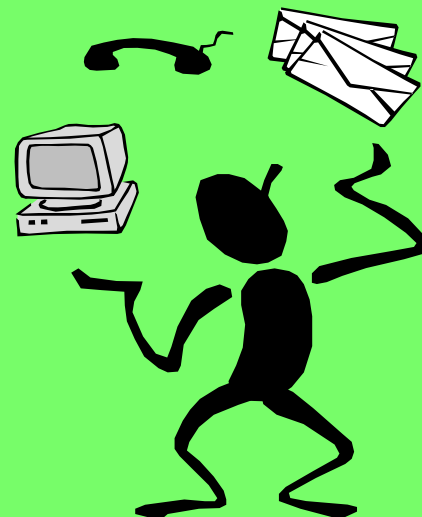
Hypothetical, potential electronic growth by market segment - using TY 2000 growth



What Are the Repeat Rates and Inter-modal Migration Rates for *e-file* Methods?



e-file Repeat Rates

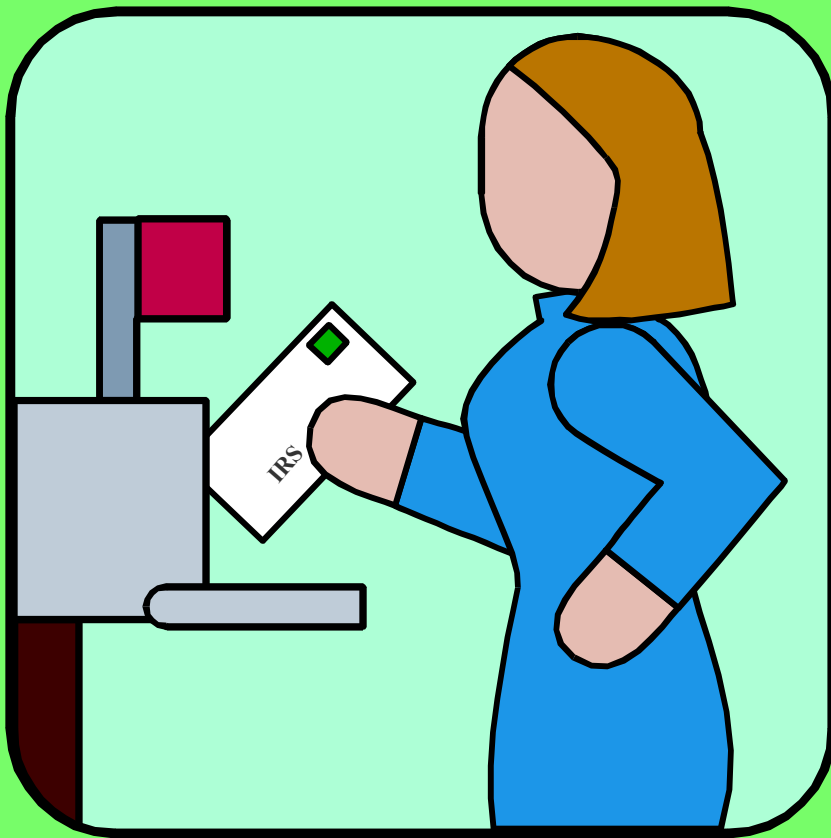


| Filing Method | Base Year 2000 | | |
|---------------|----------------|-------|-------|
| | 1999 | 1998 | 1997 |
| Paper | 85.3% | 79.3% | 75.5% |
| ELF | 81.8% | 75.5% | 68.2% |
| TeleFile | 59.3% | 43.3% | 29.0% |
| On-Line | 71.7% | 69.4% | 58.7% |

Repeat Rate by Market Segment

| Market segment | ELF | On-Line | TeleFile |
|-----------------------|-----|---------|----------|
| Self-prepared simple | 34% | 70% | 78% |
| Self-prepared complex | 43% | 84% | |
| Paid-preparer simple | 92% | | |
| Paid-preparer complex | 89% | | |

The significant differences in the profiles of *e-file* users and non-users in each market segment remain.



Differences between *e-file* users and non-users are the same as last year

- *e-file* users are younger than non-users in every market segment
- TeleFile and ELF users have lower income than non-users
- In each market segment *e-file* users more often are single, have a refund return, claim EIC and utilize direct deposit than non-users

Summary of the Differences Between *E-file* Users and Non-users Are Virtually Unchanged From Last Year

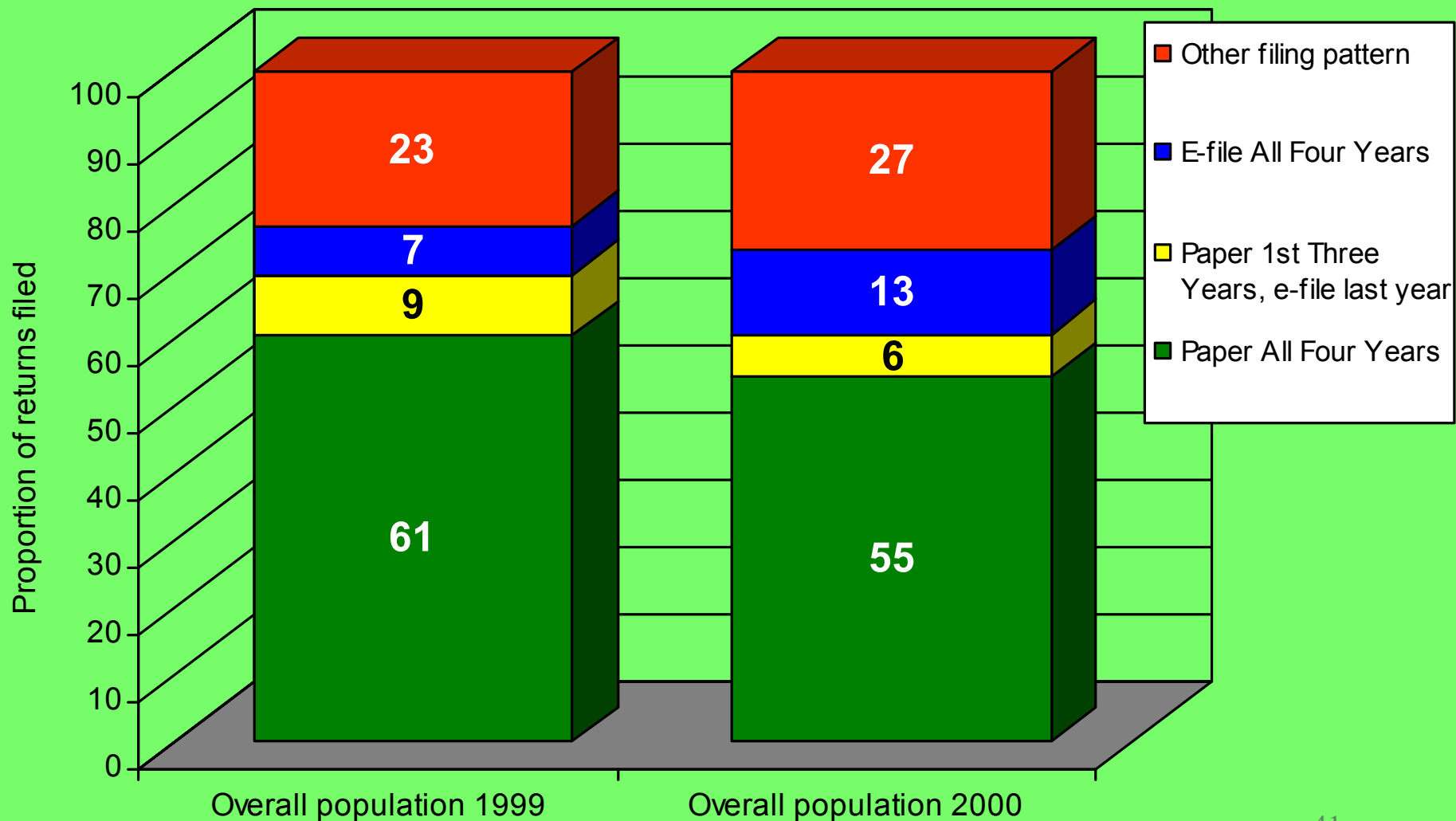
| | <i>e-file</i> user | <i>e-file</i> non-user |
|--------------------------|--------------------|------------------------|
| Average age | 37 | 44 |
| Average income | \$33,911 | \$47,321 |
| Average refund | \$1,607 | \$246 |
| Refund indicator | 92% | 71% |
| EIC indicator | 28% | 9% |
| Direct Deposit indicator | 65% | 11% |
| Filed a simple return | 55% | 45% |
| Filed a self-prep return | 34% | 52% |
| Direct Debit indicator | 1% | 0% |
| RAL indicator | 33% | 0% |

Four-Year Filing Pattern

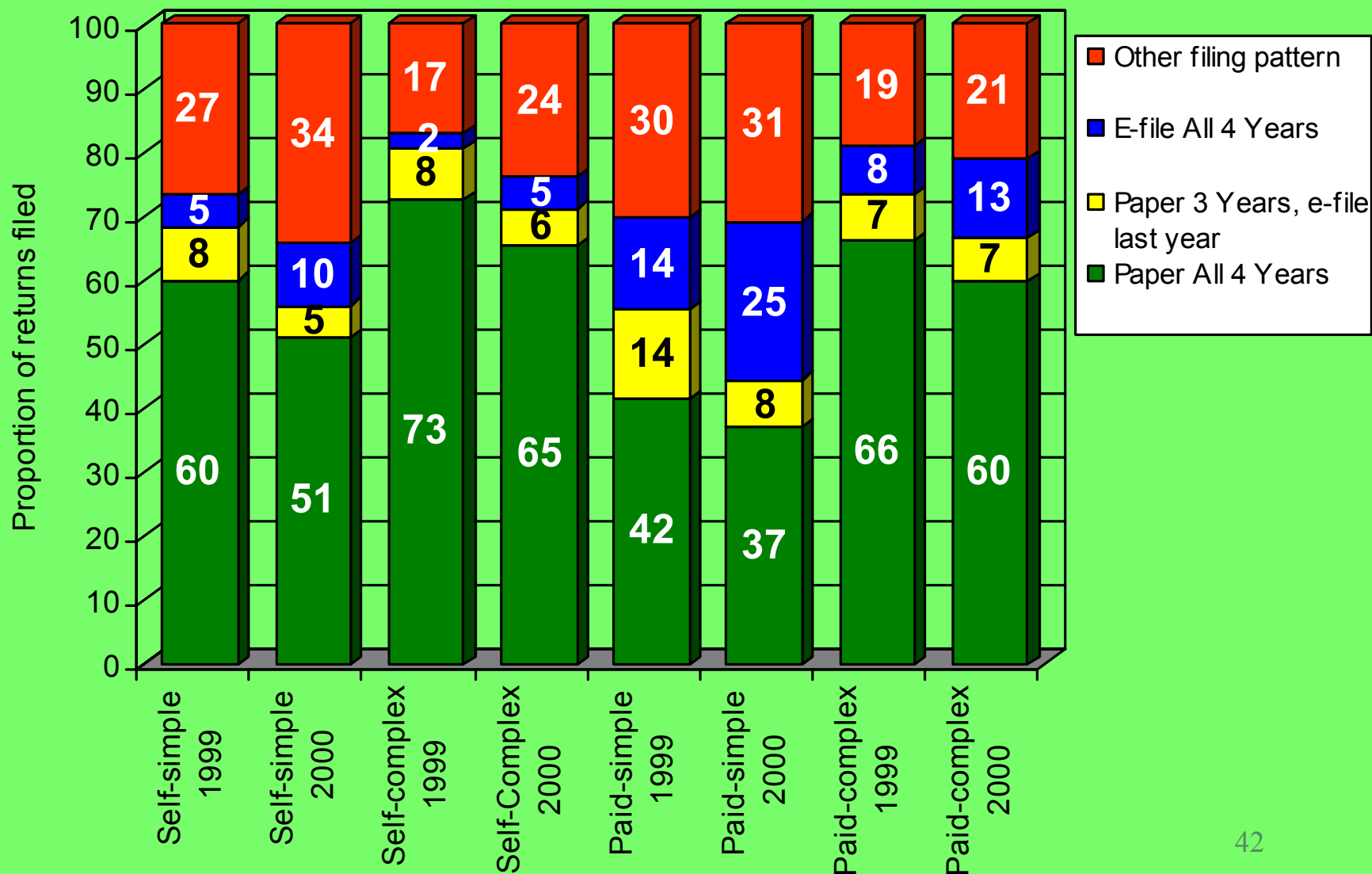
- Compared paper to electronic usage
- TY 1999 Compared to TY 2000
- TY 1999 uses 1996, 1997 and 1998 data
- TY 2000 uses 1997, 1998 and 1999 data

Four Year Filing Pattern - TY1999

Compared to TY2000



4 Year Filing Pattern - Market Segments



Analysis of Time-of-Filing

We analyzed the full-year data for TY1997, TY1998 and TY1999.

- “On-time” filers = filed before April 16
- “With-in Extension” filers = filed April 16 through October 15
- “Late” filers = filed October 16 through December 31

Time of Filing

| Time of filing | TY 1997 number of returns | TY 1997 percentage of total | TY 1998 number of returns | TY 1998 percentage of total | TY 1999 number of returns | TY 1999 percentage of total |
|----------------------------|--|--|--|--|--|--|
| On-time filers | 91,412,591 | 76.4% | 90,173,752 | 73.9% | 90,820,552 | 73.1% |
| Within-extension filers | 26,571,445 | 22.2% | 30,078,683 | 24.6% | 31,865,047 | 25.6% |
| Late filers | 1,707,503 | 1.4% | 1,802,339 | 1.5% | 1,645,654 | 1.3% |
| Total returns | 119,691,539 | 100.0% | 122,054,774 | 100.0% | 124,331,253 | 100.0% |

On-time filers - filed before April 16

Method of Filing

| | TY 1997 | TY 1998 | TY 1999 |
|---|-------------------|-------------------|-------------------|
| Paper filed | 67,092,787 | 61,206,630 | 55,907,544 |
| Electronically filed | 24,319,804 | 28,967,122 | 34,913,088 |
| Percentage electronically filed | 26.6 | 32.1 | 38.4 |
| Computer prepared | 28,654,942 | 31,177,957 | 29,713,178 |
| Percentage of paper returns computer prepared | 42.7 | 50.9 | 53.1 |
| Total filed before April 16 | 91,412,591 | 90,173,752 | 90,820,552 |

Within-extension filers - filed between April 16 and October 15

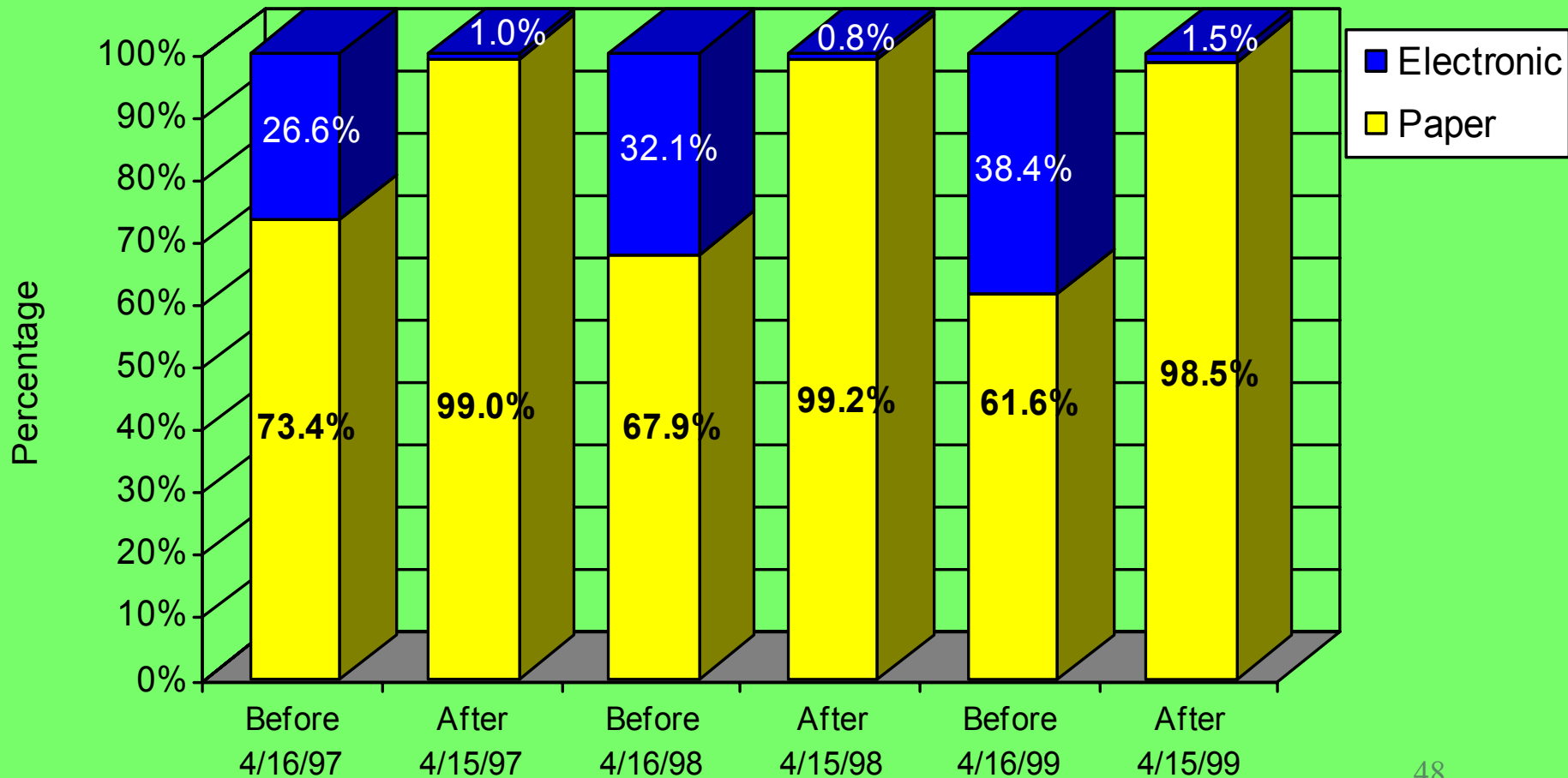
Method of Filing

| | TY 1997 | TY 1998 | TY 1999 |
|---|-------------------|-------------------|-------------------|
| Paper filed | 26,296,709 | 29,810,317 | 31,356,725 |
| Electronically filed | 274,736 | 268,366 | 508,322 |
| Percentage electronically filed | 1.0 | 0.9 | 1.6 |
| Computer prepared | 13,859,718 | 16,735,032 | 20,458,935 |
| Percentage of paper returns computer prepared | 52.7 | 56.1 | 65.2 |
| Total filed within extension time | 26,571,445 | 30,078,683 | 31,865,047 |

Relationship Between Time-of-Filing and Refunds

| | TY 1997 | TY 1998 | TY 1999 |
|--|------------|------------|------------|
| On-time filers - filed before April 16 | | | |
| Filed refund returns | 70,730,454 | 77,513,886 | 78,875,728 |
| Percentage of returns with refund | 80.7 | 86.0 | 86.8 |
| Within extension filers - filed between April 16 and October 15 | | | |
| Filed refund returns | 11,608,104 | 13,049,445 | 13,364,948 |
| Percentage of returns with refund | 43.7 | 43.4 | 41.9 |

The Relationship Between Time-of-Filing and Electronic Filing



Analysis of Time-of-Filing for Three-Year Panel

- **Background:**
- For the next analysis, we used the full-year ETA Marketing database for tax years 1997, 1998 and 1999. When all three years of returns were combined, over 140 million taxpayer records were created. Of these 140 million taxpayers, we determined the following:
 - About 19.3 million taxpayers had filed a return in only one of the three years.
 - About 17.7 million taxpayers had filed returns in only two out of the three years.
 - This left 103,062,459 taxpayer records (those who had filed returns in all three years) for analysis.

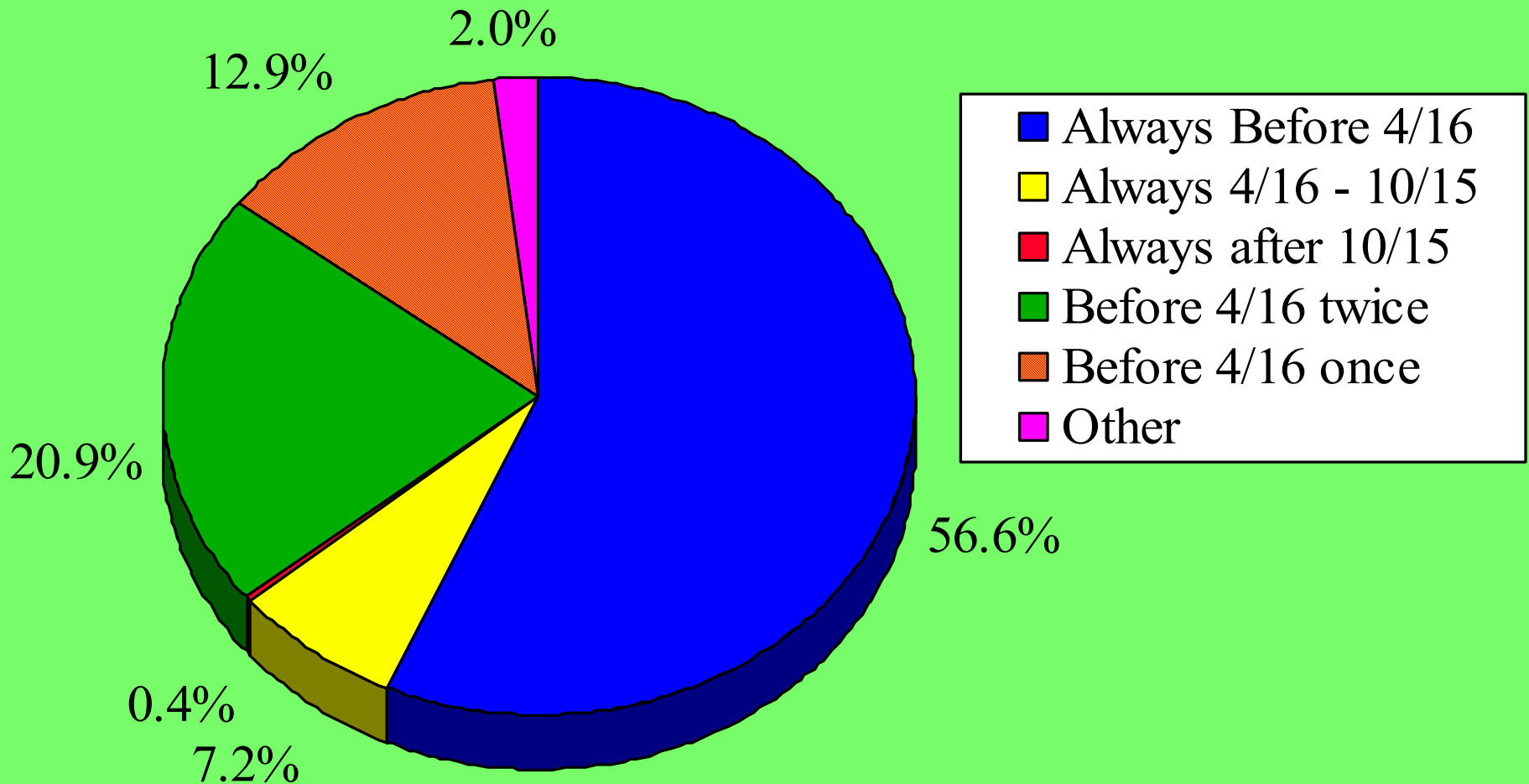
Analysis of Time-of-Filing for Three-Year Panel

- **Findings:** When we looked at the time the returns were filed for those 103 million taxpayers over tax years 1997, 1998 and 1999, we determined that:
 1. 57 percent (58 million) filed before April 16 all three years.
 2. 7 percent (7 million) filed between April 16 and October 15 all three years.

Analysis of Time-of-Filing for Three-Year Panel (continued)

3. 0.4 percent (400 thousand) filed after October 15 all three years.
4. 20.9 percent (21 million) filed before April 16 for two years and between April 16 and October 15 in one year.
5. 12.9 percent (13 million) filed before April 16 for one year and between April 16 and October 15 two years.
6. 2 percent (2 million) had some other combination of filing for the three years.

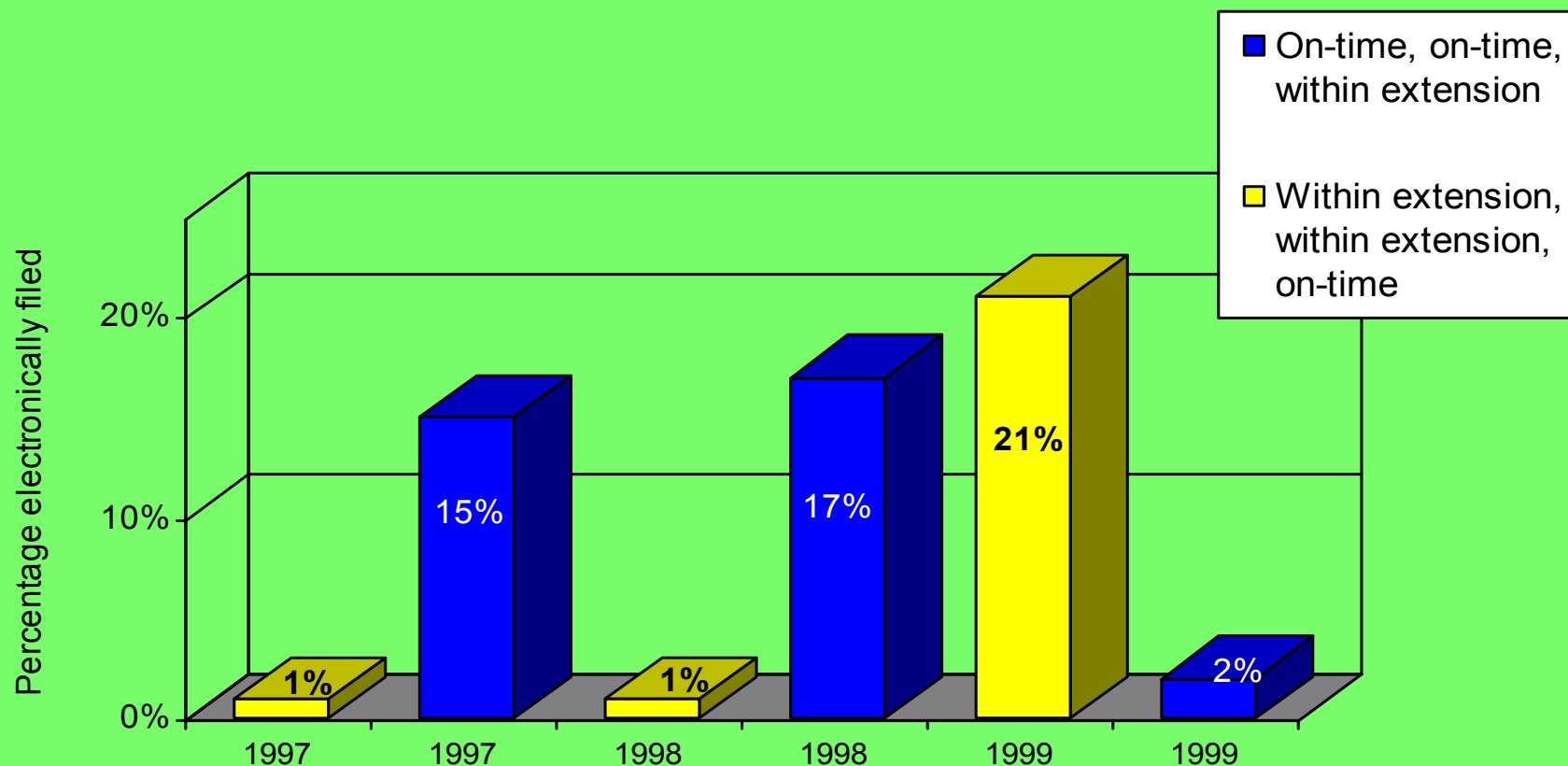
Time of Filing for 3-Year Panel



3-Year Panel: Relationship between Time-of-Filing and Electronic Filing

| How filed | Percentage of returns that are always filed on-time | Percentage of returns that are always filed within extension date | Percentage of returns that are always filed after extension date |
|-----------------------------|---|---|--|
| Always electronically filed | 23% | 0 | 0 |
| Always paper filed | 50% | 99% | 100% |
| Always hand-prepared paper | 20% | 23% | 13% |
| Always V-code | 20% | 50% | 60% |

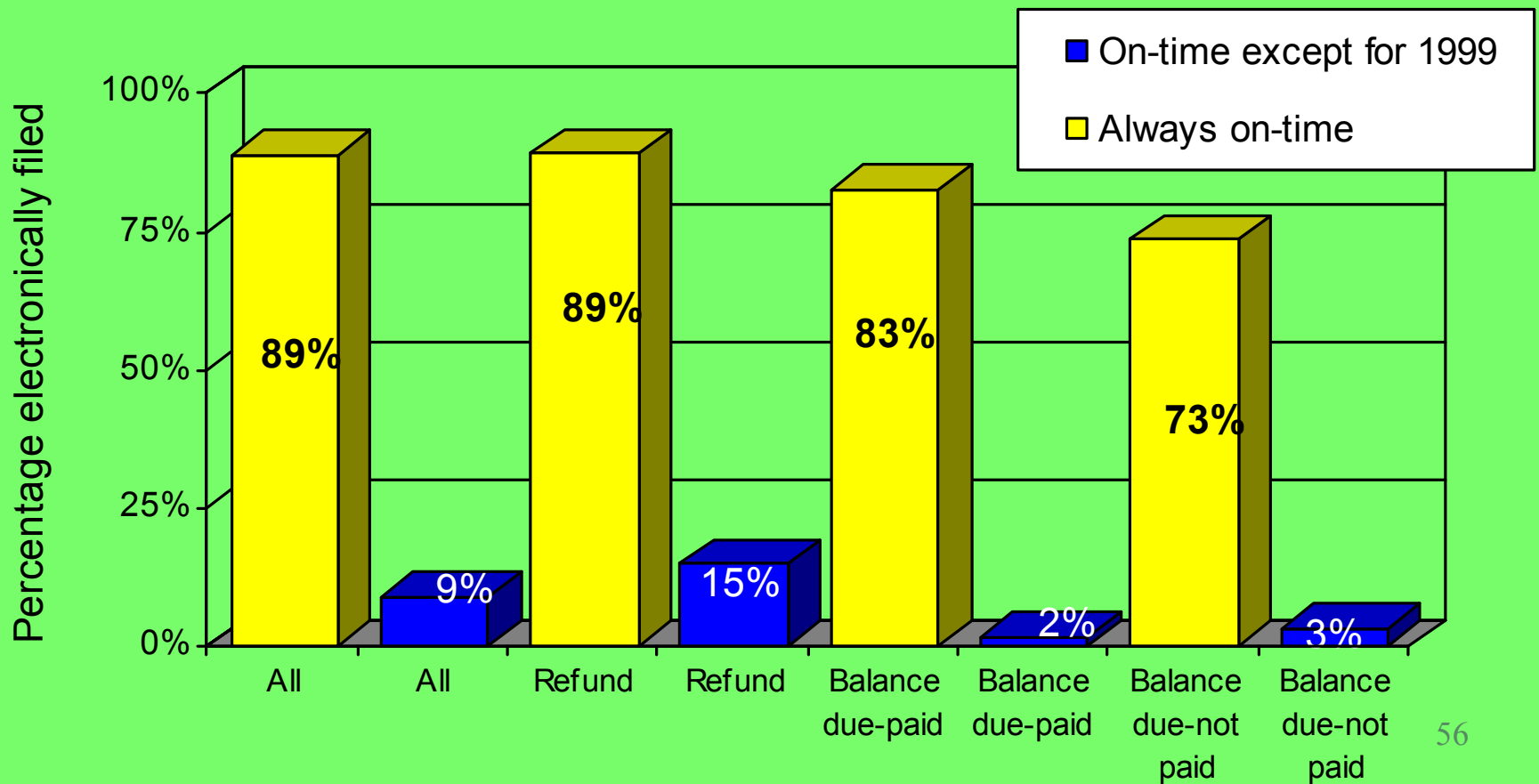
Electronic Filing and Time-of-Filing



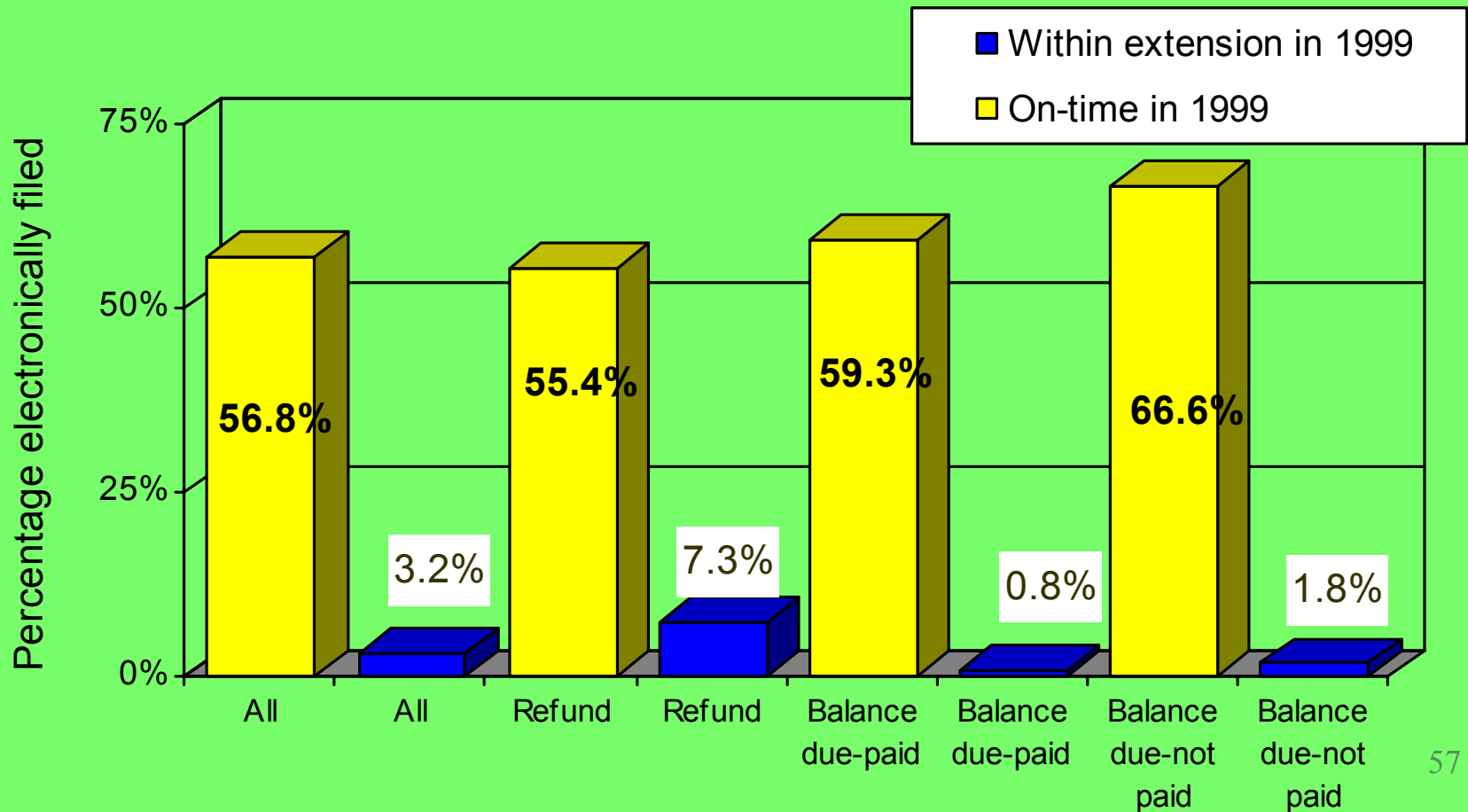
3-Year Panel: Taxpayers that filed on time and electronically in 1997 and 1998 and filed within the extension time in 1999, by method of preparation and filing.

| | Number of returns | Percentage of total returns |
|--|-------------------|-----------------------------|
| Taxpayers that changed to hand-prepared, paper for 1999 | 322,409 | 39% |
| Taxpayers that changed to V-code for 1999 | 348,010 | 42% |
| Taxpayers that changed to 1040PC for 1999 | 92,237 | 11% |
| Taxpayers that filed electronically again for 1999 (ELF or On-line) | 73,515 | 9% |
| Total returns from taxpayers who filed on-time and electronically for 1997 and 1998 and filed within the extension time for 1999 | 836,171 | 100% |

e-filed in 1997 and 1998 and Time Return Filed in 1999

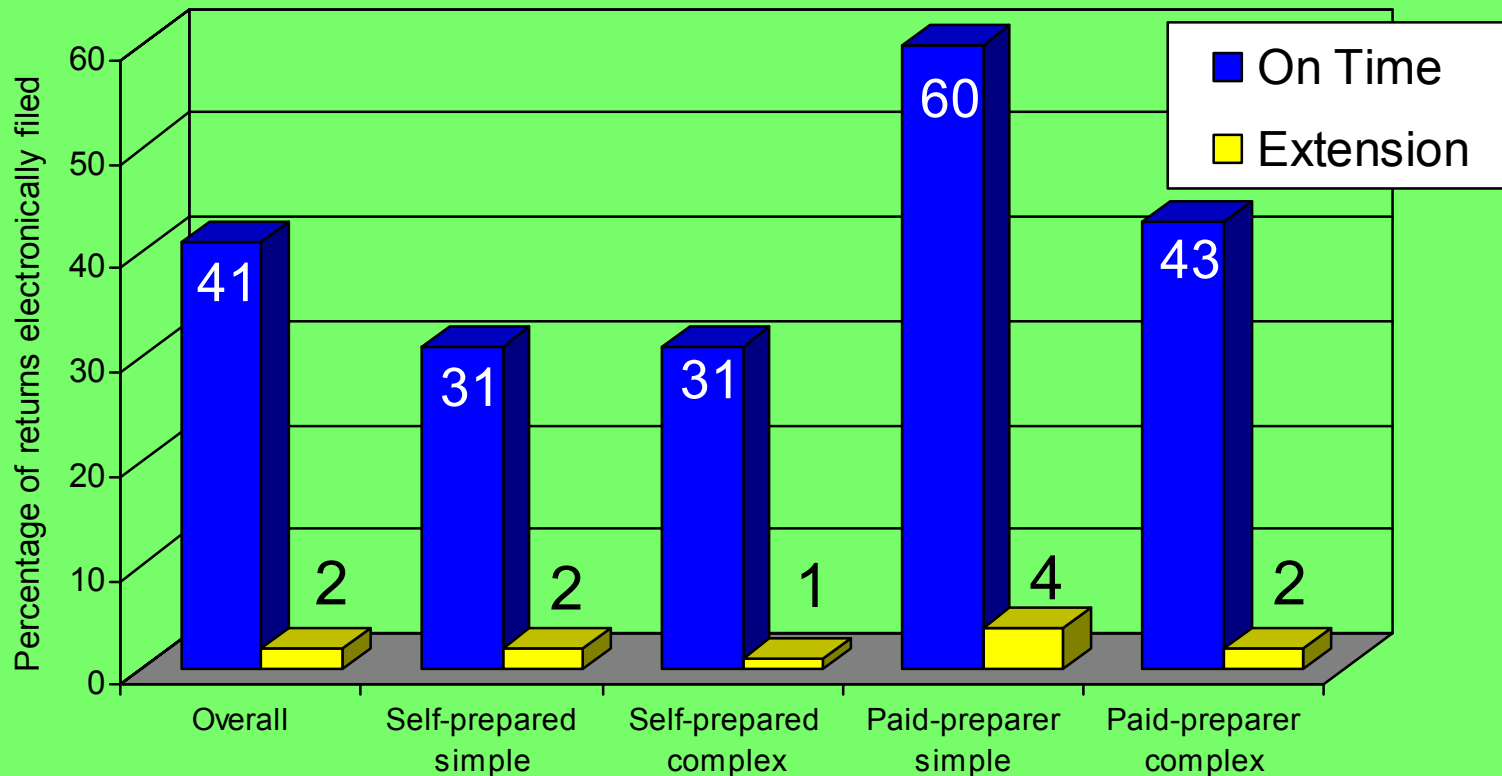


Within extension and paper filed in 1997 and 1998. How Filed in 1999:

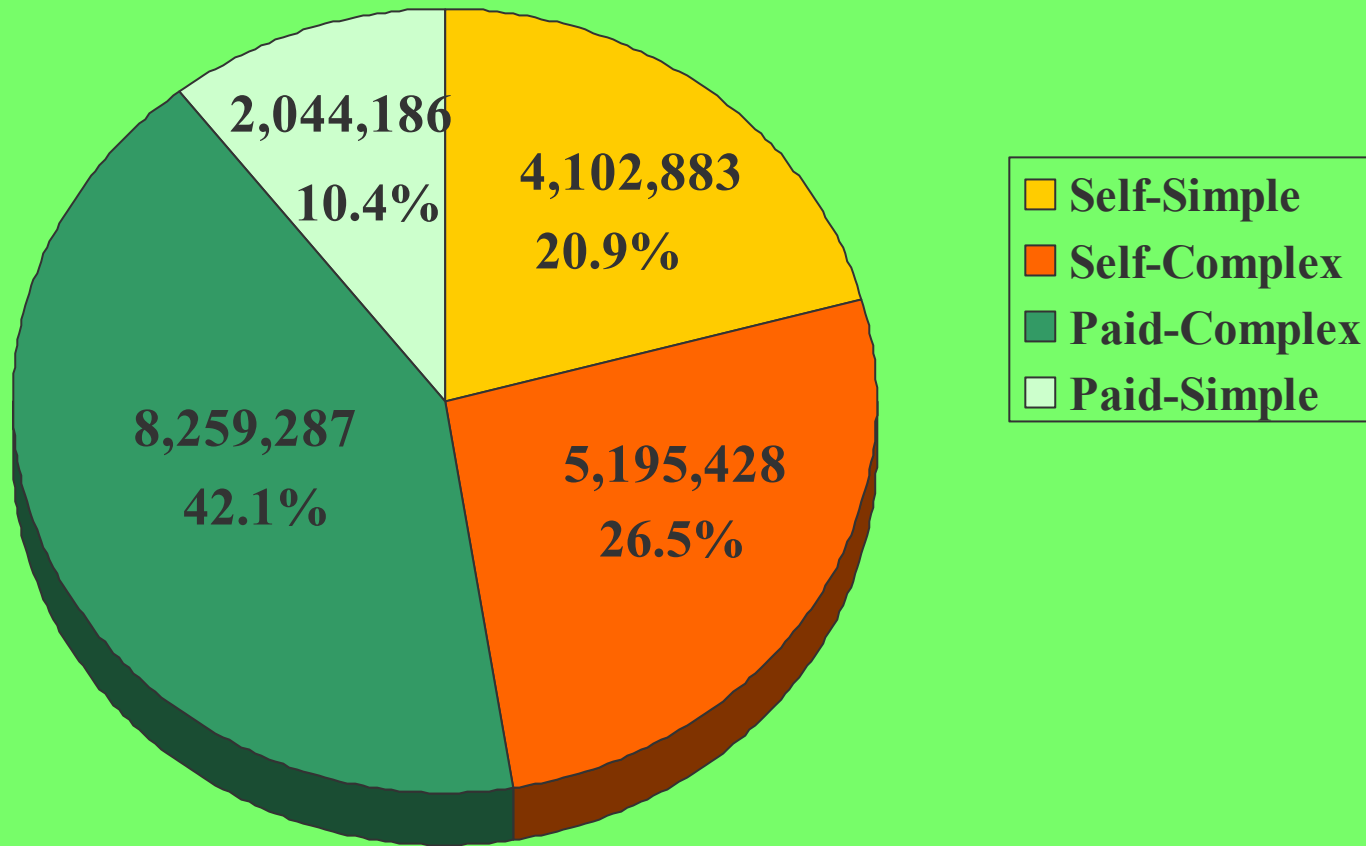


Use of electronic filing by market segment – Before and After April 15th

- 60% of the paid-preparer simple returns were electronically filed when filed by April 15th.
- In the overall population 41% of returns were electronic before April 15th and only 2% are after

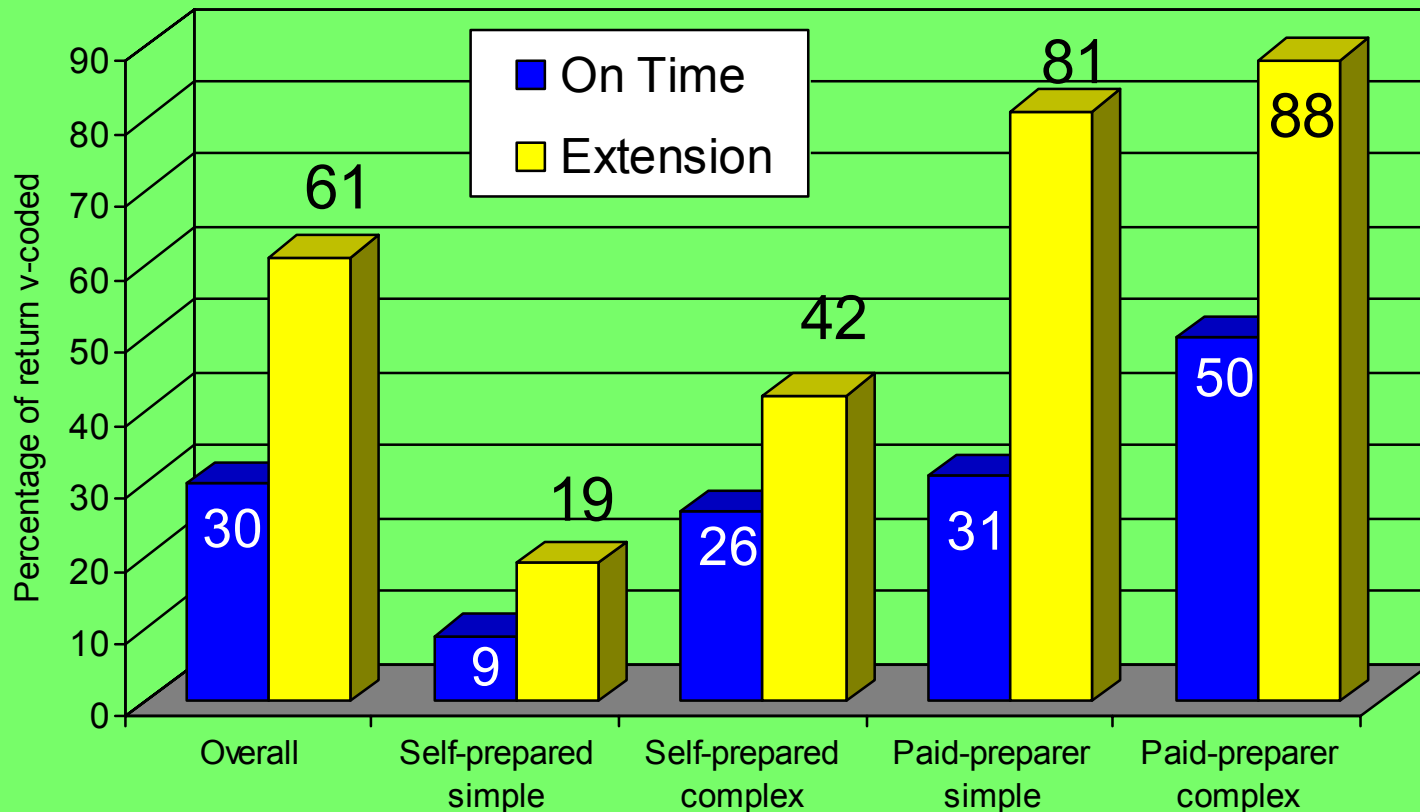


Market Segments Distribution of Filers After April 15 in TY 2000



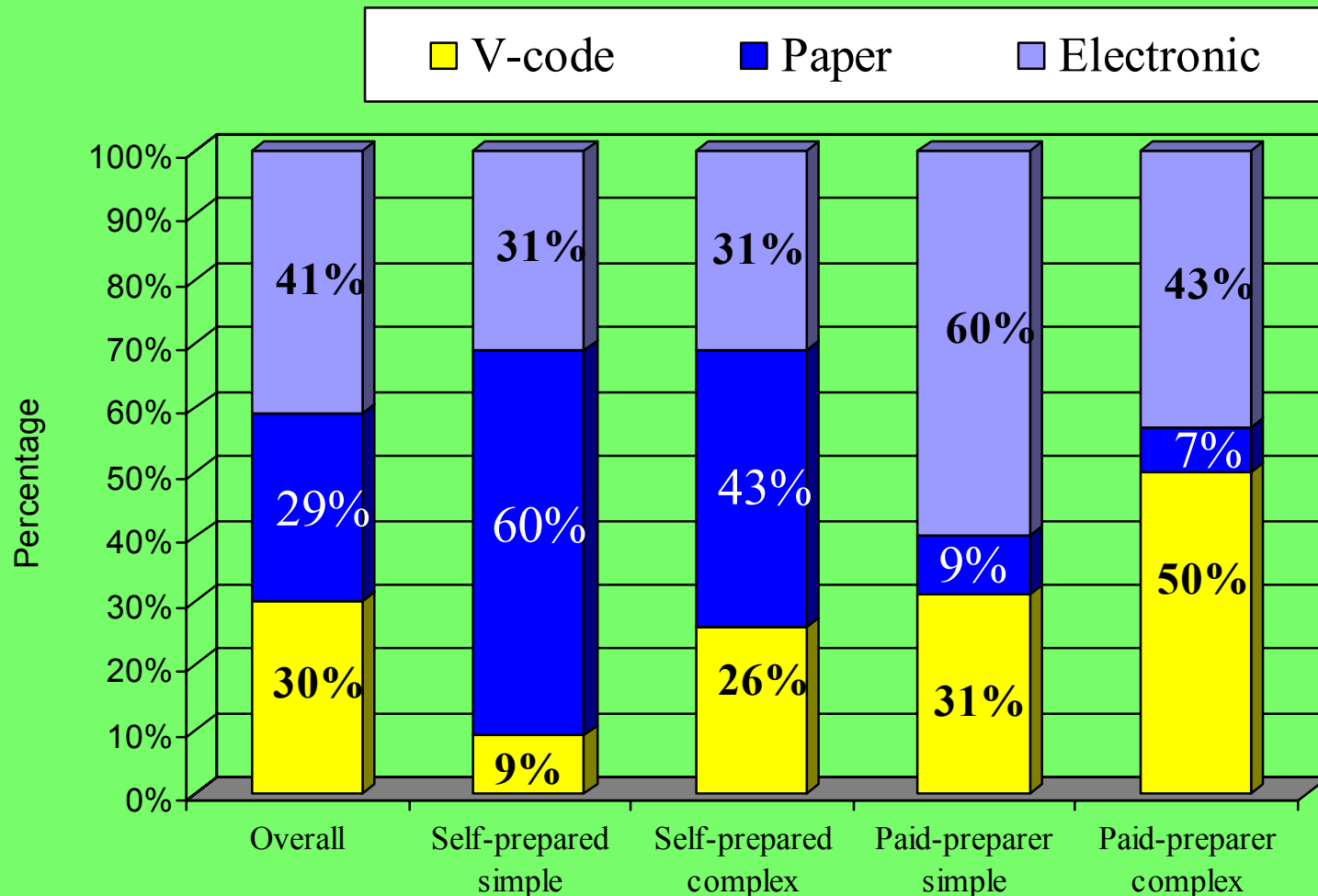
V-code Use by Market Segment – Before and After April 15th

- 88% of the paid-preparer complex returns were V-coded when filed after April 15th.
- In the self-prepared simple population only 9% of returns filed before April 15th are V-coded



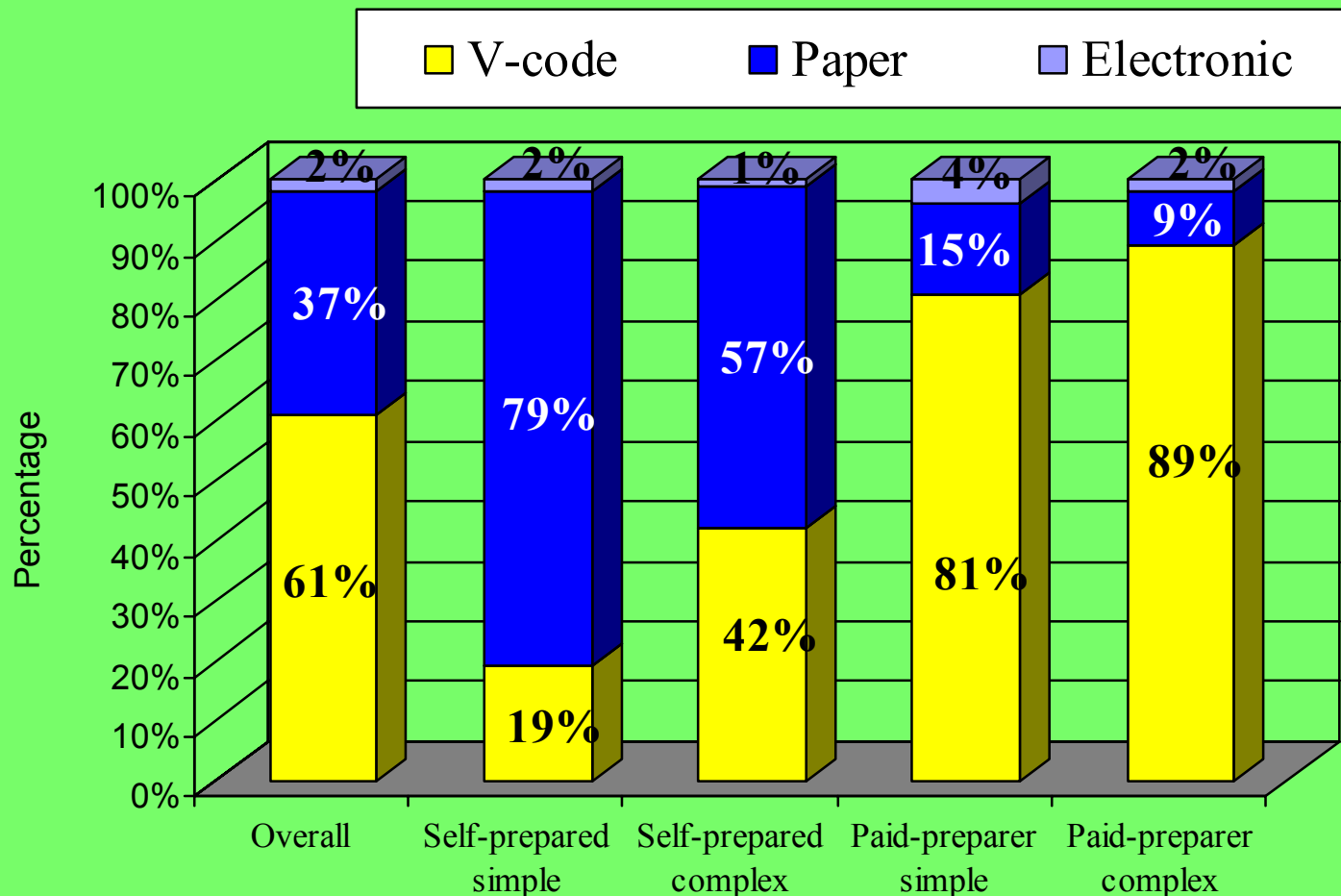
Return Category and Method of Filing before April 15

- Electronic returns exceed V-coded returns in all market segments except paid-preparer complex



Return Category and Method of Filing after April 15

- V-coded returns exceed paper returns in paid-preparer market segments, the opposite is true in self-prepared segments



Conclusion: The Difference is the Time Filed

- Returns that are paper-filed within the extension period in prior years are more likely to be filed electronically in the current year if the return is filed before April 15.
- Returns that are completed and filed electronically in prior years are more likely to be filed electronically in the current year if they are filed by April 15. This conclusion is true whether the return is self-prepared or prepared by a paid-preparer.

Conclusion: The Difference is the Time Filed

- Those taxpayer groups that file exclusively within a given time frame are quite different when it comes to refund, form complexity, use of preparers, and use of computers to file paper returns. The biggest difference is the rate of electronic filing.
- The time a return is filed has more influence on whether or not it is filed electronically than how it is prepared (self-prep or paid-preparer) or the balance status (refund or balance due). *Time-of-filing appears to be the biggest factor in the taxpayer's decision whether or not to electronically file a return.*

Time-of-Filing Recommendation

- Specific marketing with a different message to taxpayers who file after April 15.
- The potential benefit of targeted marketing is a possible gain of 12 million *e-filers*.

Computer Prepared Returns

- V-code returns (computer-prepared, but paper filed returns)
- Electronically filed returns (ELF and On-Line)

Computer prepared, paper returns increased TY 1998 to TY 2000

| | TY 1998 | TY 1999 | TY 2000 | Percentage change TY 1998 to TY 1999 | Percentage change TY 1999 to TY 2000 |
|-------------------------------|------------|------------|------------|--|--|
| Paper returns | 74% | 69% | 65% | -8% | -9% |
| V-code | 34% | 35% | 35% | 15% | 6% |
| Other paper | 35% | 31% | 30% | -22% | -9% |
| Electronic returns | 26% | 31% | 35% | 20% | 20% |
| Total | 100% | 100% | 100% | - | - |

The total number of V-coded paper returns increased by 527,000 returns from TY 1999 and now comprises 54% of all paper filed returns and 35% of all returns.

Computer-prepared returns by market segment

- 91% of the paid-preparer simple segment and 93% of the paid-preparer complex segment are computer prepared.

| Market segment | Hand prepared, paper return | V-coded returns | <i>e-file</i> returns | Percentage of segment computer prepared |
|---|--------------------------------|--------------------|--------------------------|--|
| Self-prepared simple | 58% | 8% | 22% | 37% |
| Self-prepared complex | 27% | 15% | 12% | 54% |
| Paid-preparer simple | 7% | 21% | 33% | 91% |
| Paid-preparer complex | 8% | 56% | 33% | 93% |
| Total | 100% | 100% | 100% | 70% |
| Method of filing as a percent of total returns | 30% | 35% | 35% | 100% |

The percentage of hand-prepared, paper returns in each market segment show little change from TY 1999.

Percentage of each market segment by method of filing
 Paid-preparer returns have a higher proportion of V-code returns than the self-prepared segments.

| Market segment | Hand prepared, paper return | V-coded returns | Electronic returns | Total | Percent of segment computer prepared |
|---|--------------------------------|--------------------|-----------------------|-------|---|
| Self-prepared simple | 63% | 10% | 27% | 100% | 37% |
| Self-prepared complex | 46% | 30% | 24% | 100% | 54% |
| Paid-preparer simple | 9% | 36% | 55% | 100% | 91% |
| Paid-preparer complex | 8% | 58% | 34% | 100% | 93% |
| Method of filing as a percent of total returns | 31% | 35% | 30% | 100% | 70% |

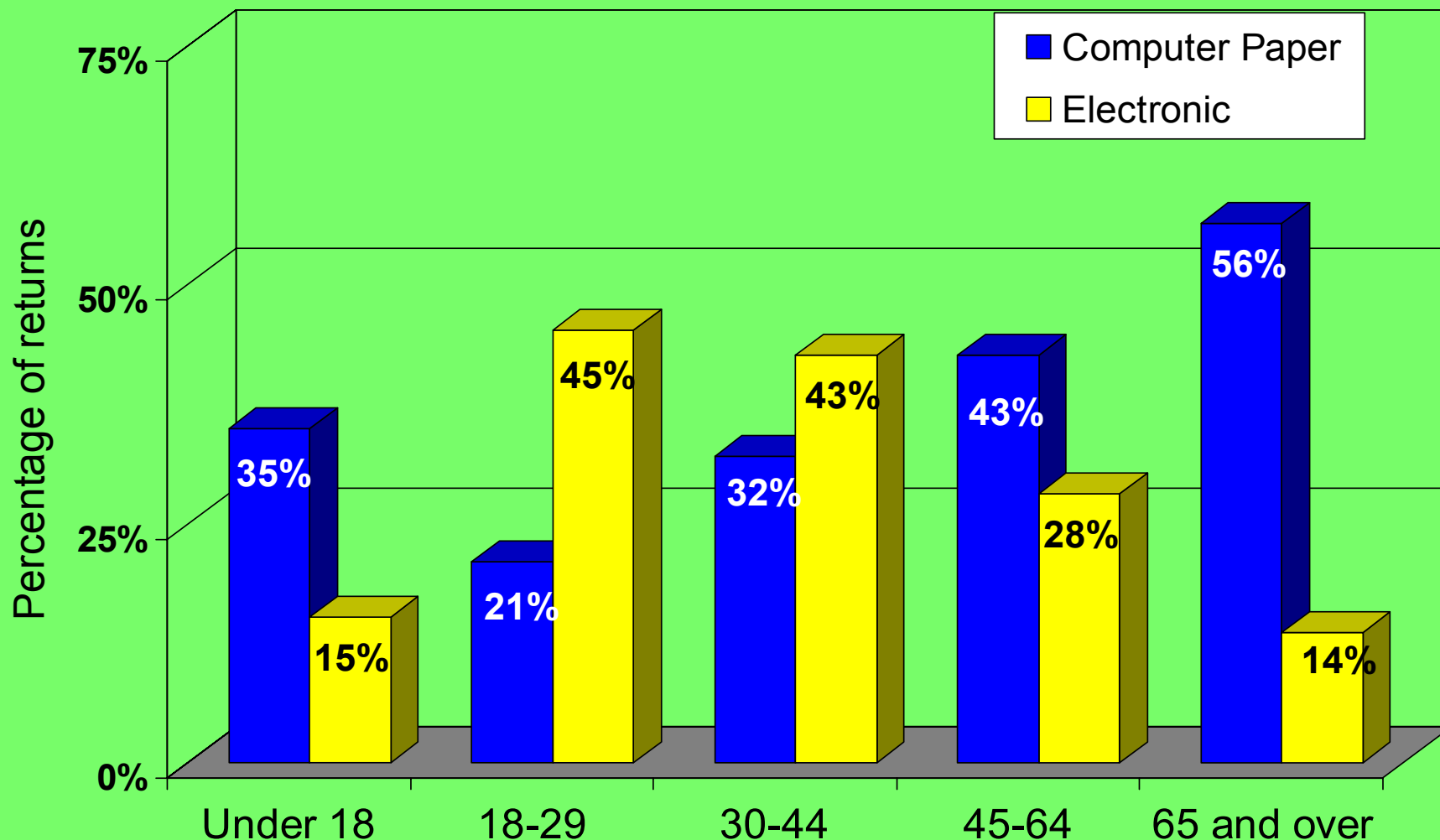
63% of the returns filed in the self-prepared, simple segment are hand-prepared, paper returns

58% of the returns filed in the paid-preparer, complex segment are computer prepared, but paper-filed.

Computer usage compared to electronic usage

| Market Segment | Percentage of segment computer prepared | Percentage computer prepared and electronically filed |
|-----------------------|---|---|
| Self-prepared simple | 37% | 27% |
| Self-prepared complex | 54% | 24% |
| Paid-preparer simple | 91% | 55% |
| Paid-preparer complex | 93% | 34% |
| Total | 70% | 35% |

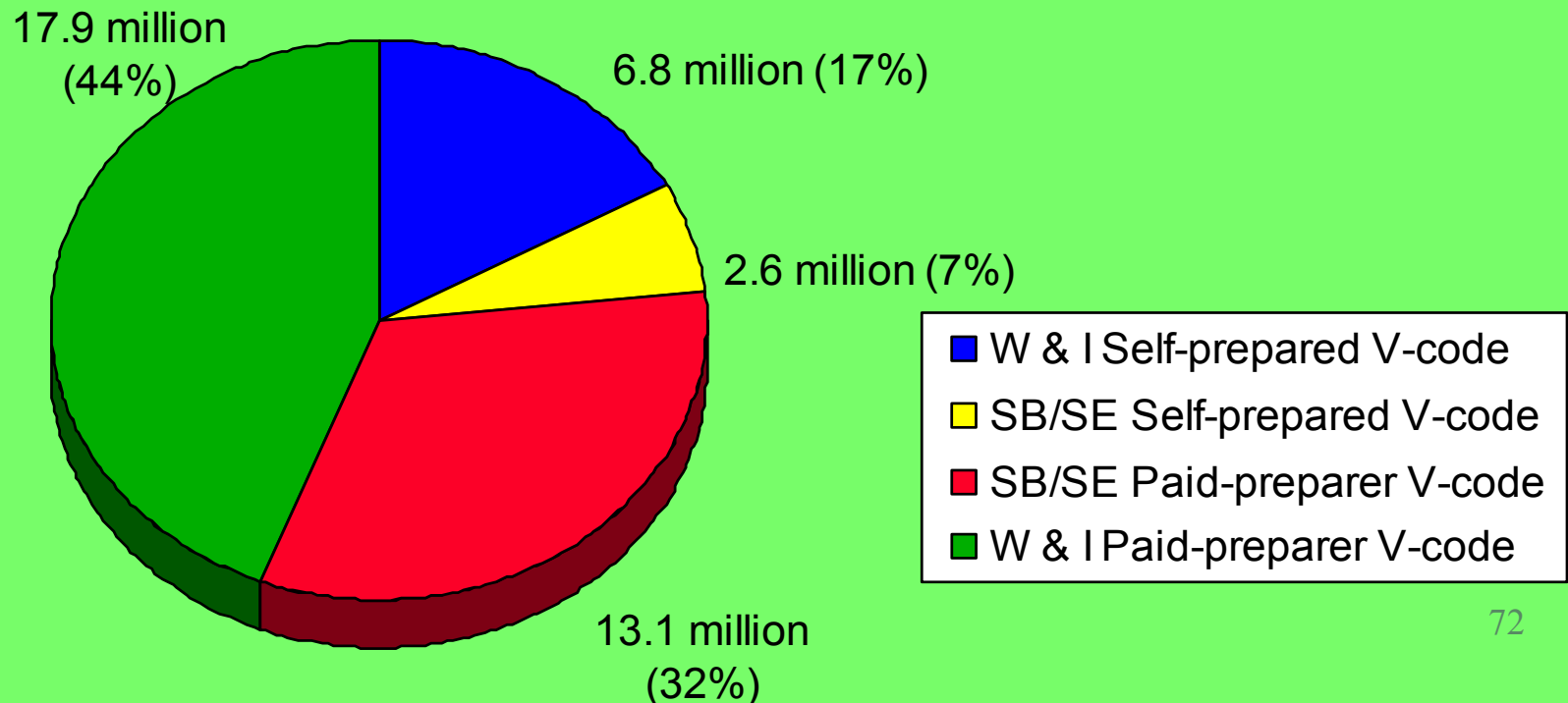
V-code and Age



Almost 1/3 of V-coded returns are filed by taxpayers age 45 to 64

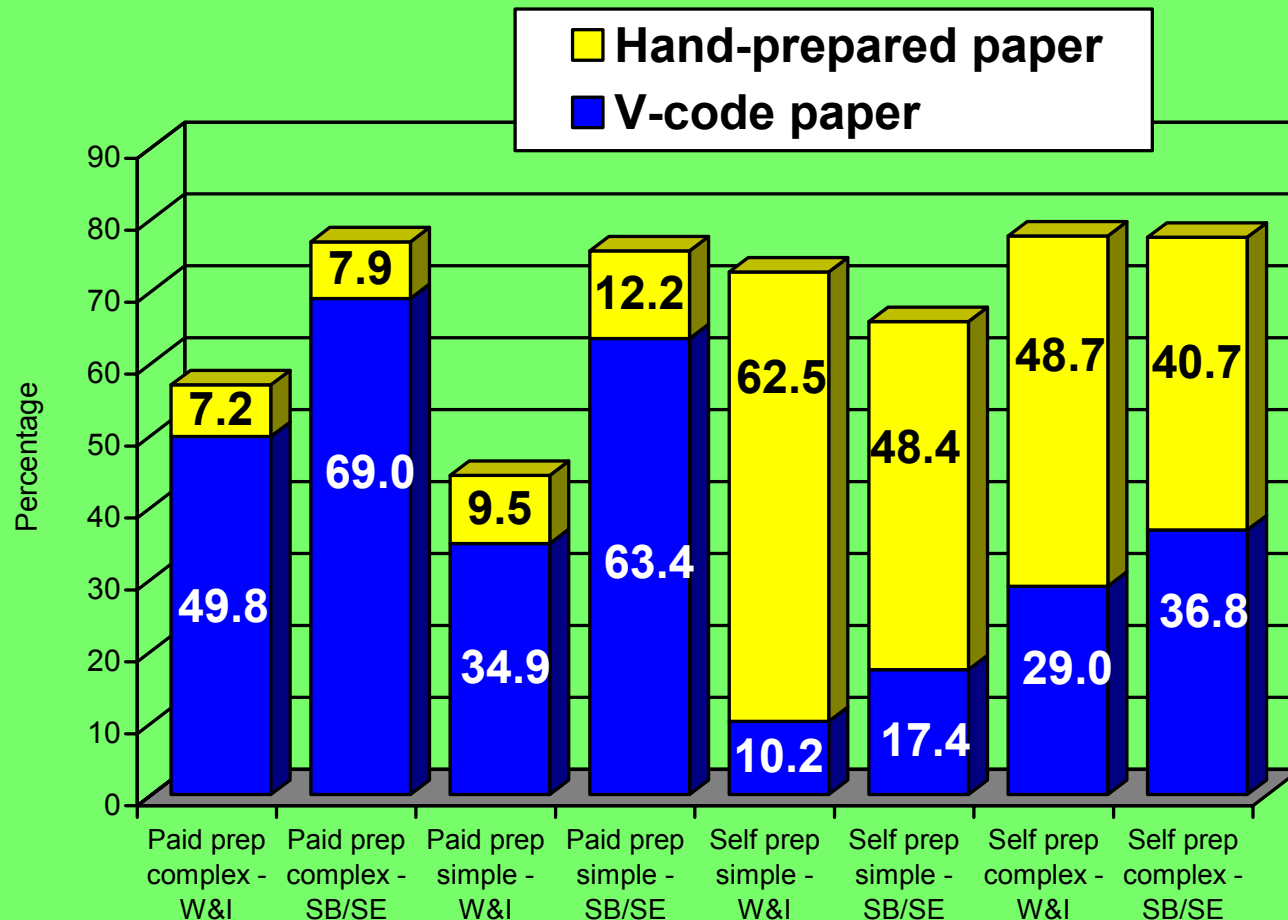
V-code returns, operating divisions and market segments

- 76% of the V-code returns are prepared by paid-preparers
- 44% of the V-code returns are prepared by paid-preparers and are in the W&I division



V-code in business operating divisions

- The proportion of V-code returns is higher in the SB/SE division in all four segments.
- V-code usage went up on a percentage basis in all segments except the paid-preparer complex segments.



V-code Summary

- 35% of all TY2000 returns are V-coded returns
- V-coded returns comprise 54% of all paper returns filed
- V-coded returns make up 86% of all paid-preparer paper returns
- Over 50% of taxpayers with AGI of \$50,000 or more filed V-coded returns

Computer Prepared Returns Summary

- 62% of self-prepared simple returns are hand prepared paper returns
- These taxpayers (about 20 million), or 17% of all filers, have no *e-file* product
- An internet based equivalent to TeleFile would not compete with private industry (only 22,000 1040EZ v-code returns) and would provide an electronic filing option to this segment

Form 1040PC Migration

- 4.2 million filers used Form 1040PC in TY 1999.
- Form 1040PC was no longer accepted in TY 2000
- How did those 1999-1040PC filers file in TY 2000?

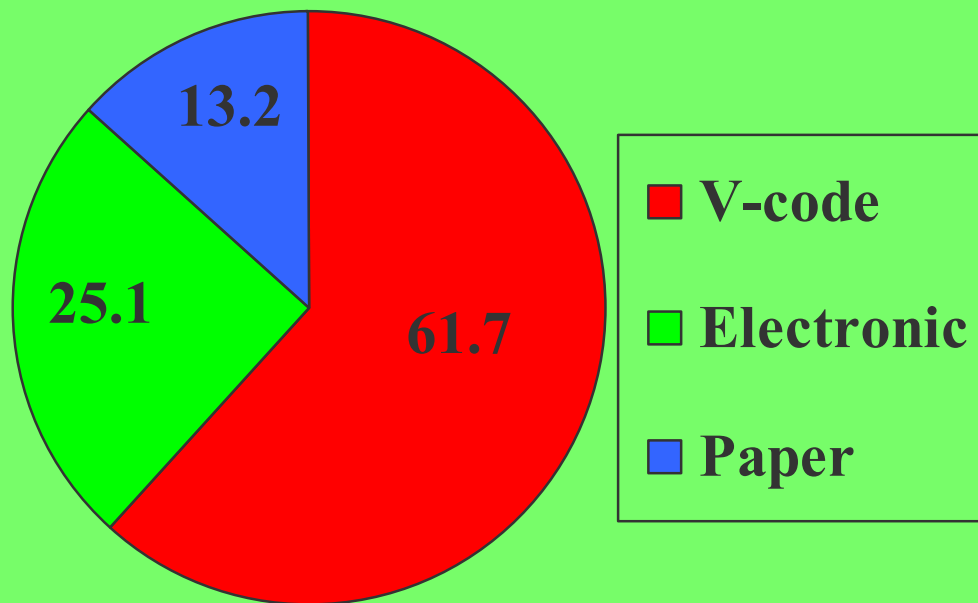
This is how they filed in TY 2000:

| | ELF | TeleFile | On-Line | V-code | Paper | Total |
|---------------------|---------|----------|---------|-----------|---------|-----------|
| Number of returns | 908,740 | 26,280 | 313,041 | 2,426,670 | 553,852 | 4,228,583 |
| Percentage of total | 21.5% | 0.6% | 7.4% | 57.4% | 13.1% | 100.0% |

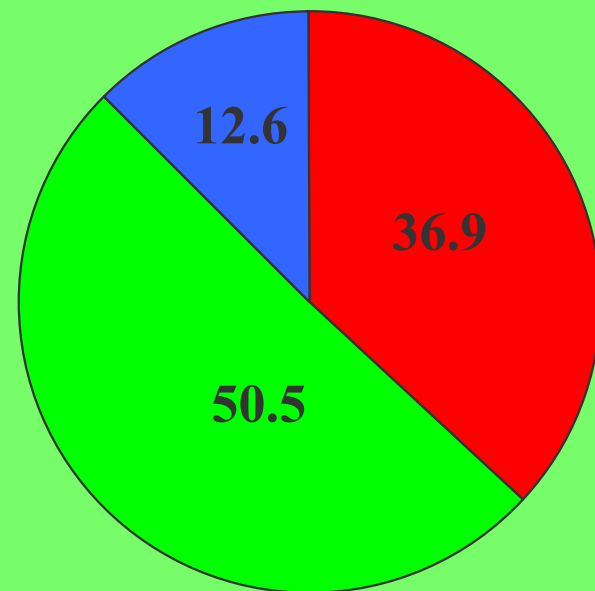
- Over 57% filed a V-coded paper return in 2000.
- Less than 30% filed electronically.

Those 1040PC filers who had tried an electronic method of filing prior to 1999 used electronic in 2000 more often than exclusive paper filers:

•Always Used Paper



•Tried Electronic



Why does TeleFile usage continue to decrease?

Are TeleFile users less loyal to TeleFile than other electronic filers are to their method?

Is there a future for TeleFile?



The number and percentage of TeleFile returns filed for tax years 1996 through 2000

| Tax year | Number of TeleFile returns | Percentage of total returns |
|----------|----------------------------|-----------------------------|
| TY 1996 | 4,682,576 | 4.2 |
| TY 1997 | 5,915,184 | 5.2 |
| TY 1998 | 5,658,966 | 5.1 |
| TY 1999 | 5,153,011 | 4.5 |
| TY 2000 | 4,414,206 | 3.8 |

The decrease in the number of TeleFile users has accelerated in each of the last three years

Despite reducing the number of packages mailed by 25%, meeting the TeleFile eligibility criteria is a continuing problem for TeleFile package recipients

| | TY 1998 | | | TY 1999 | | | TY 2000 | | |
|---|-------------------|-------------|-------------|-------------------|-------------|-------------|-------------------|-------------|-------------|
| Package recipient and filed a return | 21,677,461 | 100% | | 20,285,051 | 100% | | 15,332,766 | 100% | |
| Eligible to TeleFile | 13,757,870 | 63% | 100% | 12,648,968 | 62% | 100% | 9,533,119 | 62% | 100% |
| Eligible and used TeleFile | 5,658,966 | 26% | 41% | 5,153,011 | 25% | 41% | 4,414,206 | 29% | 46% |
| Not eligible to TeleFile | 7,919,591 | 37% | | 7,653,188 | 38% | | 5,804,647 | 38% | |

Though overall use of TeleFile went down, use of TeleFile among eligible TeleFile package recipients increased by over 10% from TY 1999

Why was the taxpayer ineligible to TeleFile?

| TeleFile Ineligible Reason | Number of Returns | Percent of Total |
|------------------------------|-------------------|------------------|
| Taxpayer Moved | 2,093,943 | 36% |
| Schedules Attached | 364,926 | 6% |
| Estimated Payments | 308,875 | 5% |
| Other Form | 305,695 | 5% |
| Student Loan | 112,545 | 2% |
| Changed Filing Status | 111,149 | 2% |
| Over \$50,000 Income | 69,727 | 1% |
| Income Adjustments | 37,669 | 1% |
| Claimed Dependents | 33,220 | 1% |
| Other Reasons * | 22,827 | 0% |
| Multiple Reasons | 2,344,071 | 40% |
| Total | 5,804,647 | 100% |

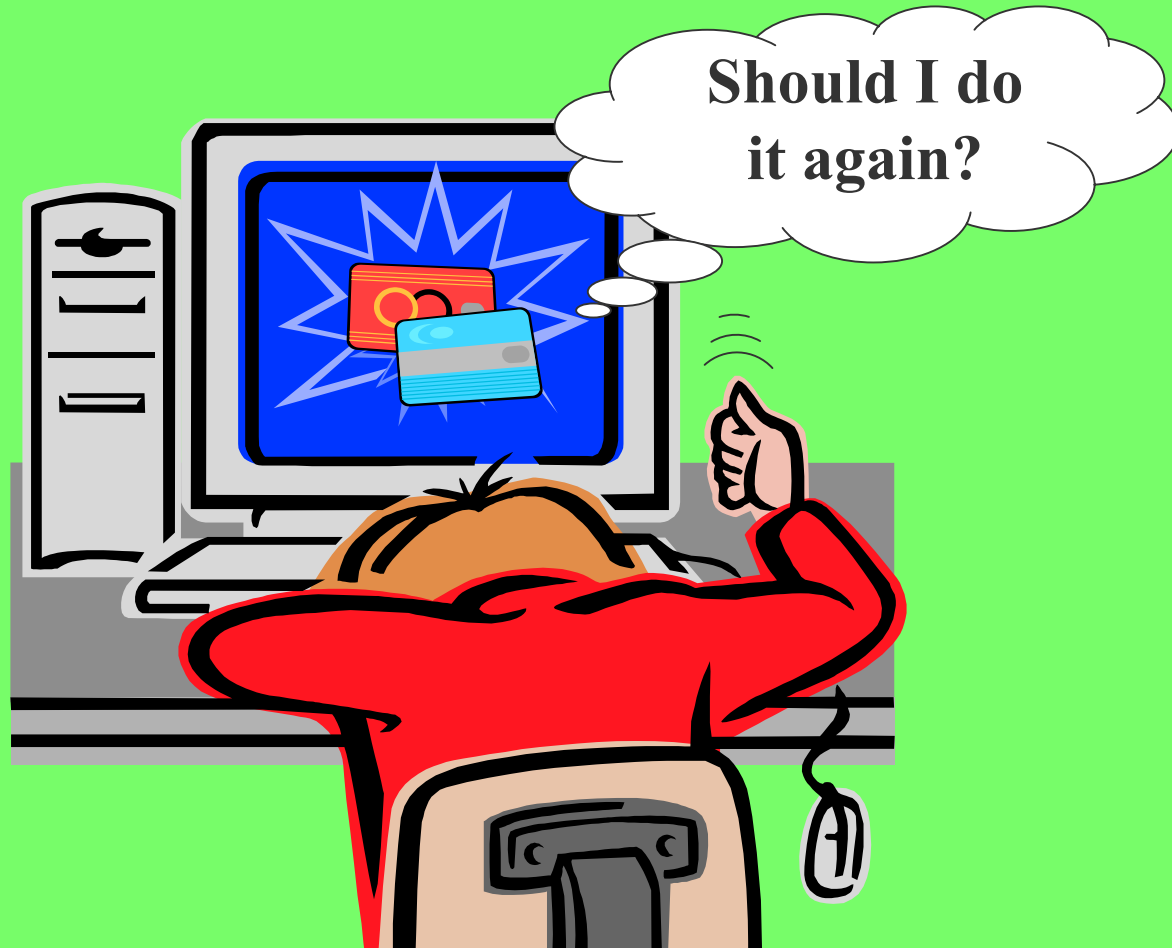
•*Over 65, interest over \$400, educational credits, other credits

Multiple Reasons for ineligibility to TeleFile

| TeleFile Ineligible Reason | Frequency of Occurrence | |
|----------------------------------|-------------------------|------------|
| | Number | Percent |
| Taxpayer Moved | 3,287,365 | 57% |
| Schedules Attached | 1,068,851 | 18% |
| Estimated Payments | 956,929 | 16% |
| Changed Filing Status | 924,088 | 16% |
| Credits Claimed | 874,866 | 15% |
| Claimed Dependents | 737,304 | 13% |
| Income Adjustments | 714,065 | 12% |
| Education Credit | 516,185 | 9% |
| Student Loan | 410,703 | 7% |
| Other Form | 305,695 | 5% |
| Interest Income >\$399 | 230,338 | 4% |
| Over \$50,000 Income | 205,087 | 4% |

Again, moving is the number one reason taxpayers can not TeleFile

**What happened to TeleFile?
Are TeleFile users less loyal than filers
of other types of electronic returns?**



Loyal TeleFilers Background

- ◆ In 1996, 4.7 million TeleFile returns were filed.
 - ◆ We can track about 3.8 million of those filers who used TeleFile in 1996 through the 2000 tax year.
 - ◆ By 2000, only 26% of the 3.8 million we can track are still using TeleFile.
-
- Can our multi-year database help us determine why?
 - Can this help explain why TeleFile is no longer growing?

Why do loyal TeleFile users skip a year?

- We examined those who used TeleFile between 1996 and 2000 and skipped only 1998
- 66% were not eligible to use TeleFile in 1998; over 90% of those had moving as a reason for ineligibility
- There was a similar result when those who skipped 1997 only were looked at
- It appears as if loyal users are *forced* to leave TeleFile

We can track about 3.8 million of the filers who filed using TeleFile in the 1996 tax year through the 2000 tax year.

In Tax Year 1997:

| | Number of returns | Percentage |
|--|-------------------|-------------|
| Taxpayers that filed a return in 1997 | 3,781,656 | 97.8 |
| Taxpayers that were eligible to TeleFile for TY 1997 | 2,752,257 | 72.8 |
| • Taxpayers that used TeleFile in 1997 | 2,377,449 | 86.4 |
| Taxpayers that were not eligible* to TeleFile for TY 1997 | 1,029,399 | 27.2 |
| • Taxpayers that used paper in 1997 | 867,867 | 84.3 |

***Why taxpayers were ineligible to use TeleFile in TY 1997:**

34 percent because of moving only

76 percent of **all** single and multiple reasons included moving

In Tax Year 1998:

| : | Number of returns | Percentage |
|--|-------------------|-------------|
| Taxpayers that filed a return in 1998 | 3,778,541 | 97.8 |
| Taxpayers that received a TeleFile package and were eligible to TeleFile for TY 1998 | 2,111,646 | 55.9 |
| • Taxpayers that used TeleFile in 1998 | 1,771,830 | 83.9 |
| Taxpayers that received a TeleFile package but were not eligible* to TeleFile for TY 1998 | 825,510 | 21.8 |
| • Taxpayers that used paper in 1998 | 639,797 | 77.5 |
| Taxpayers that did not receive a TeleFile package for TY 1998 | 841,385 | 22.3 |
| • Taxpayers that used paper in 1998 | 667,560 | 79.3 |

***Why taxpayers who received a TeleFile package, but could not use TeleFile in TY 1998, were ineligible:**

33 percent because of moving only,

59 percent of **all** single and multiple reasons included moving.

In Tax Year 1999:

| | Number of returns | Percentage |
|--|-------------------|-------------|
| Taxpayers that filed a return in 1999 | 3,864,877 | 100.0 |
| Taxpayers that received a TeleFile package and were eligible to TeleFile for TY 1999 | 1,859,171 | 48.1 |
| • Taxpayers that used TeleFile in 1999 | 1,396,733 | 75.1 |
| Taxpayers that received a TeleFile package but were not eligible* to TeleFile for TY 1999 | 690,700 | 17.9 |
| • Taxpayers that used paper in 1999 | 481,750 | 69.8 |
| Taxpayers that did not receive a TeleFile package for TY 1999 | 1,315,006 | 34.0 |
| • Taxpayers that used paper in 1999 | 916,273 | 69.8 |

***Why taxpayers who received a TeleFile package, but could not use TeleFile in TY 1999, were ineligible:**

32 percent because of moving only,

65 percent of all single and multiple reasons included moving,

In Tax Year 2000:

| | Number of returns | Percentage |
|--|-------------------|-------------|
| Taxpayers that filed a return in 2000 | 3,492,831 | 90.5 |
| Taxpayers that received a TeleFile package and were eligible to TeleFile for TY 2000 | 1,256,287 | 36.0 |
| • Taxpayers that used TeleFile in 2000 | 1,011,624 | 80.5 |
| Taxpayers that received a TeleFile package but were not eligible* to TeleFile for TY 2000 | 572,640 | 16.4 |
| • Taxpayers that used paper in 2000 | 481,750 | 69.8 |
| Taxpayers that did not receive a TeleFile package for TY 2000 | 1,663,904 | 47.6 |
| • Taxpayers that used paper in 2000 | 916,273 | 69.8 |

*** Why taxpayers who received a TeleFile package, but could not use TeleFile in TY 2000, were ineligible:**

32 percent because of moving,

65 percent of **all** multiple and single reasons included moving

Loyal TeleFilers Summary

- **In 1996**

4.7 million TeleFile returns were filed

- **By 2000**

1.2 million (25 percent) of those filers had become secondary filers or had stopped filing

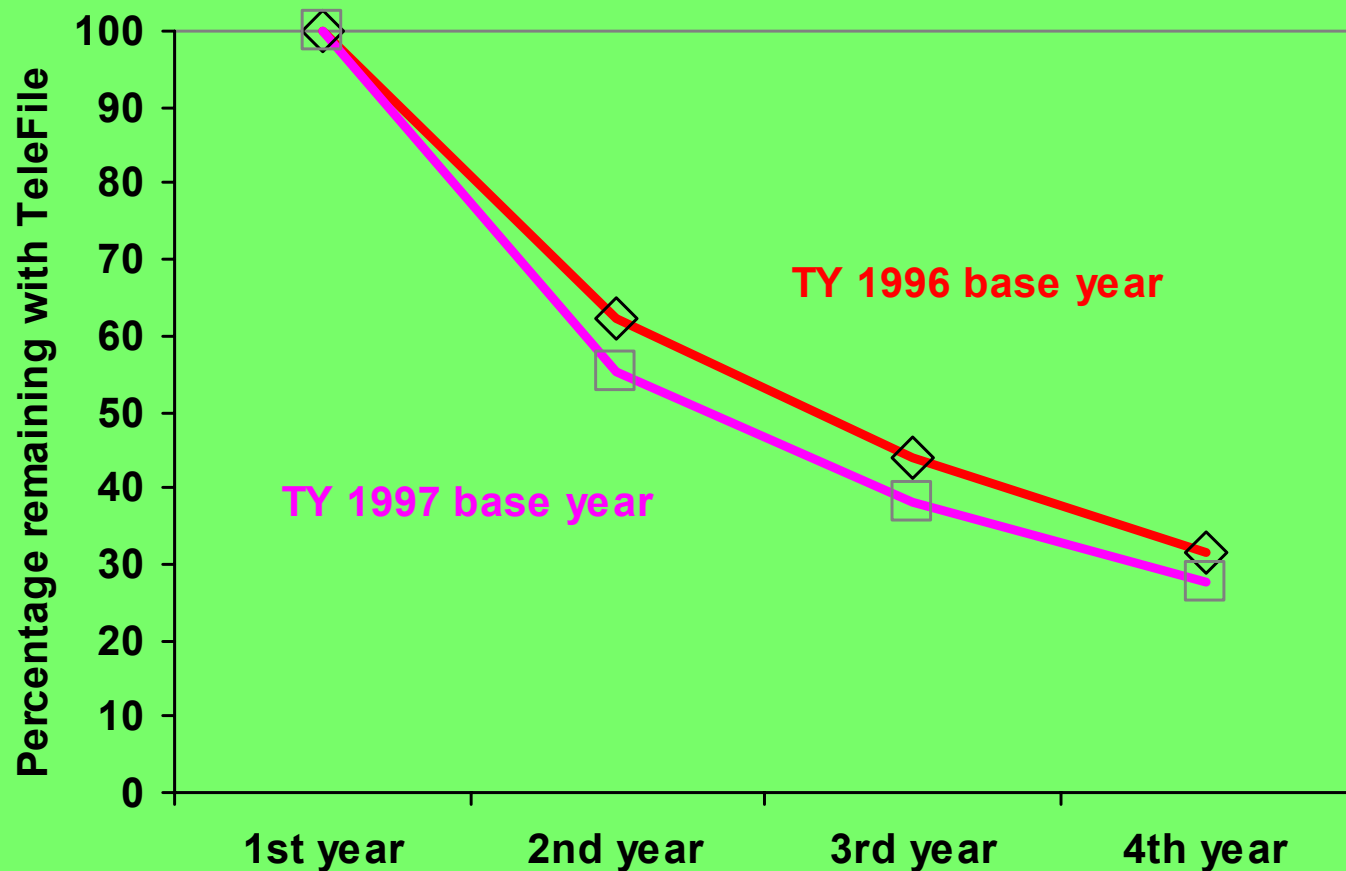
Only 1.8 million (39 percent) still received a TeleFile package

Only 1 million (22 percent) still filed using TeleFile

TeleFile Facts

- The 4-year repeat rate of 22% means that every 4 years you must replace almost 4 out of 5 TeleFile users
- The majority of those who receive a TeleFile package choose TeleFile or paper as their filing option
- TeleFile use has fallen each year since 1997.
Is the rate that people become ineligible or quit TeleFile increasing since then as well?

Taxpayers leave TeleFile at a slightly faster rate than previously:



TeleFile Repeat Rates Compared to Other Electronic Methods

- Of those who used an *e-file* method in 1999, what percentage used it again in 2000?

ELF 82%

On-Line 72%

TeleFile 59%

- If we adjust our figures by removing those no longer eligible to Telefile, the TeleFile repeat rate is 92%.

TeleFile Summary

- In TY 2000 almost 11 million TeleFile package recipients filed using paper; this represents 10% of all filers
- Moving consistently plays a part in about 60% of the ineligibility for TeleFile
- If the ineligibility obstacle could be removed TeleFile users are the most loyal customers we have
- Because of ineligibility they are our least loyal customers

1) TeleFile should be modified to allow changes at irs.gov:

- >Year-to-year repeat rate of 5% is lowest among the three IRS electronic products.
- >38% who got package this year were ineligible; over 60% of those were moving related.
- >Only 46% eligible to use package do so.
- >Taxpayers who leave TeleFile migrate back to paper.
- >First-time simple filers can't use TeleFile as it is now.

2) Moving would be removed as an obstacle to TeleFile

- >This could be done through an Internet option identical to the TeleFile telephone script which would allow address changes.
- >This does not compete with the private sector software companies since only 0.2% of 1040EZ returns are computer-prepared and paper filed.

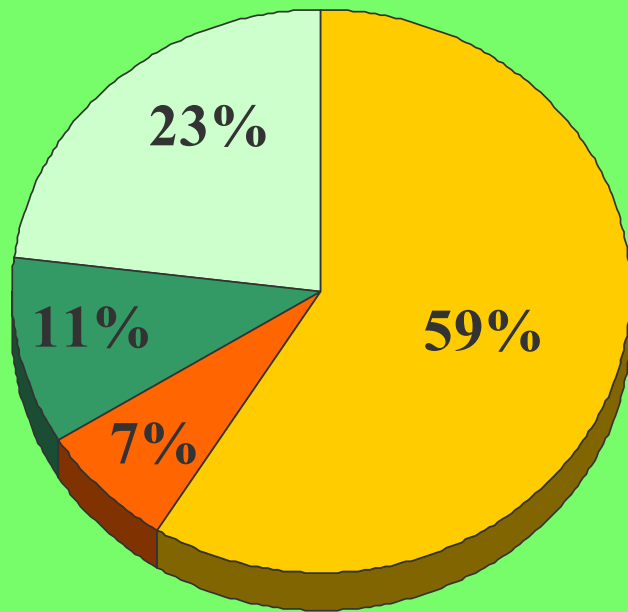
Analysis of Dependent Filers

- **There were 10.3 million taxpayers who were claimed as a dependent on another's return.**
- **Most (59%) filed a self-prepared, simple return.**
- **88% are under 21 years old**
- **95% show an AGI of under \$15,000**
- **Less than 5% are first-time filers**
- **About one-third have filed for the last four years.**

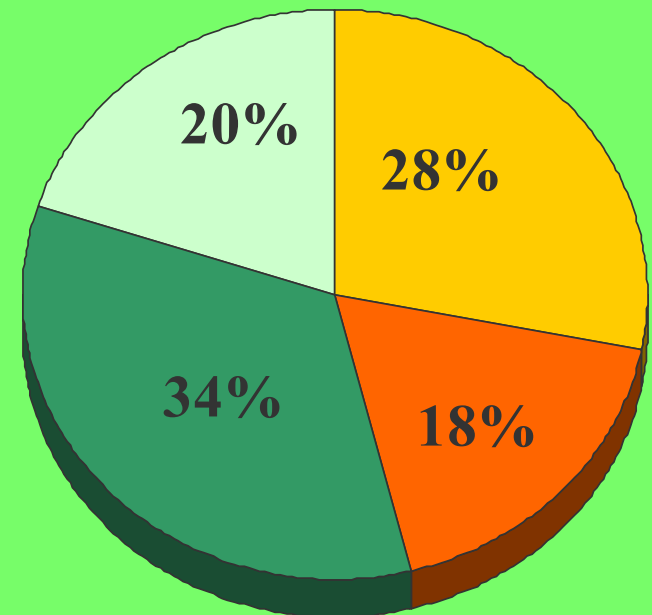
Dependents Compared to All Filers

Market Segments

Dependents



All Filers

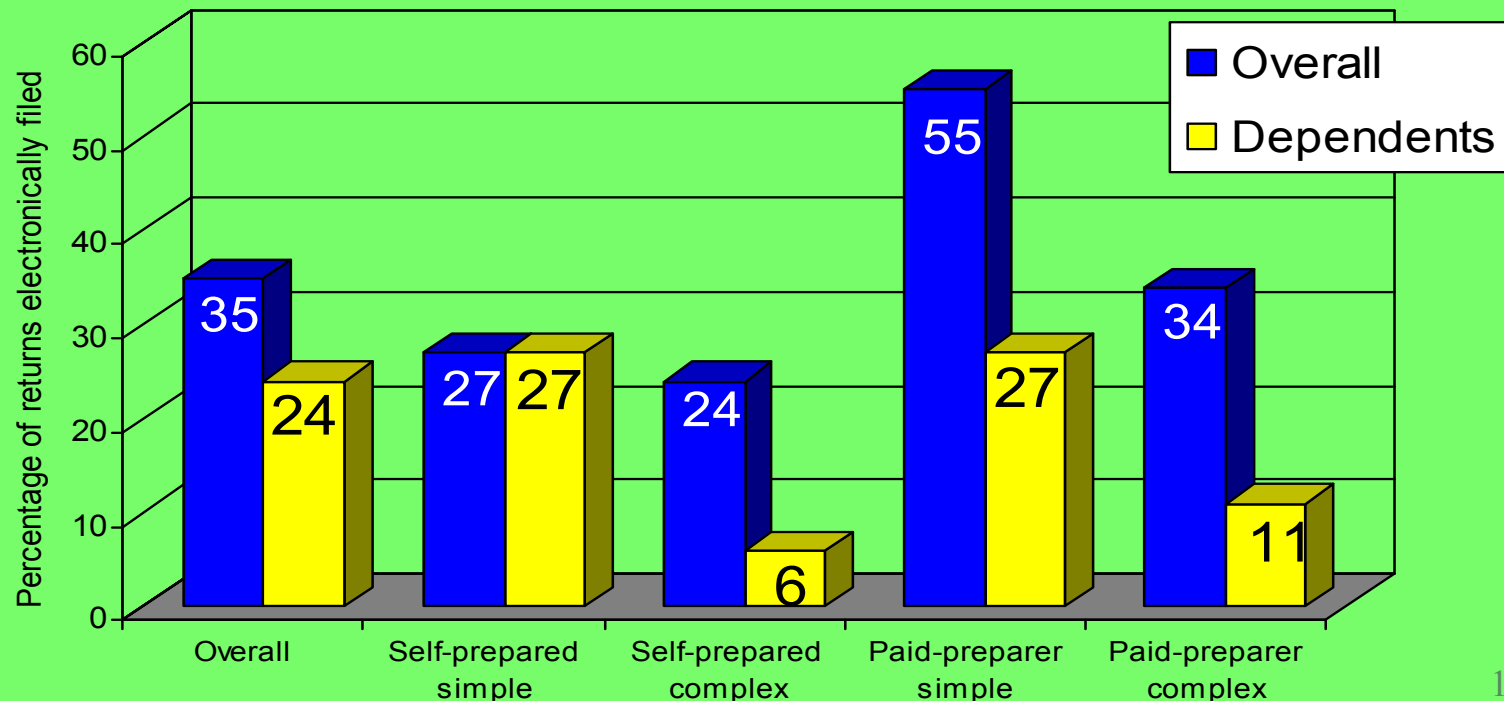


Summary of the Differences Between Dependents and All Filers

| | Dependent | All Filers |
|---------------------------------|------------------|-------------------|
| Age under 18 | 38% | 4% |
| Age under 21 | 88% | 8% |
| Age 18-29 | 60% | 26% |
| AGI under \$15,000 | 95% | 30% |
| Refund indicator | 75% | 79% |
| If Balance Due, Full Pd | 93% | 86% |
| EIC indicator | .1% | 16% |
| Direct Deposit indicator | 11% | 29% |
| Filed a simple return | 82% | 48% |
| Filed a self-prep return | 66% | 46% |
| Direct Debit indicator | .3% | .3% |
| RAL indicator | 33% | 0% |

Comparison of Electronic Filing By Dependents and All Filers

- 24% of dependents electronically filed while 35% of all filers electronically filed.
- The self-prepared complex return market has the least *e-file* penetration in the overall population at 24%. The penetration rate for dependents is only 6% for this segment.



Other Dependent Characteristics

- Under 5% are first time filers and dependent first time filers use *e-file* on 12% of filings; for all first time filers it is 21%
- About 33% filed the last four years
- Dependent filers in this group use *e-file* 28%, for all filers the rate is 35%
- 19% of dependents are loyal *e-file* users, for all filers the rate is 25%

Parents' Use of *e-file* Strongly Influences Dependents' Use of *e-file*

We used returns where a preparer SSN was in the data one time and a return was filed using that SSN in our file

- If the parent filed paper
The dependent filed paper 96% of the time
- If the parent used an *e-file* method
The dependent used *e-file* 43% of the time

Self-Prepared Simple Returns

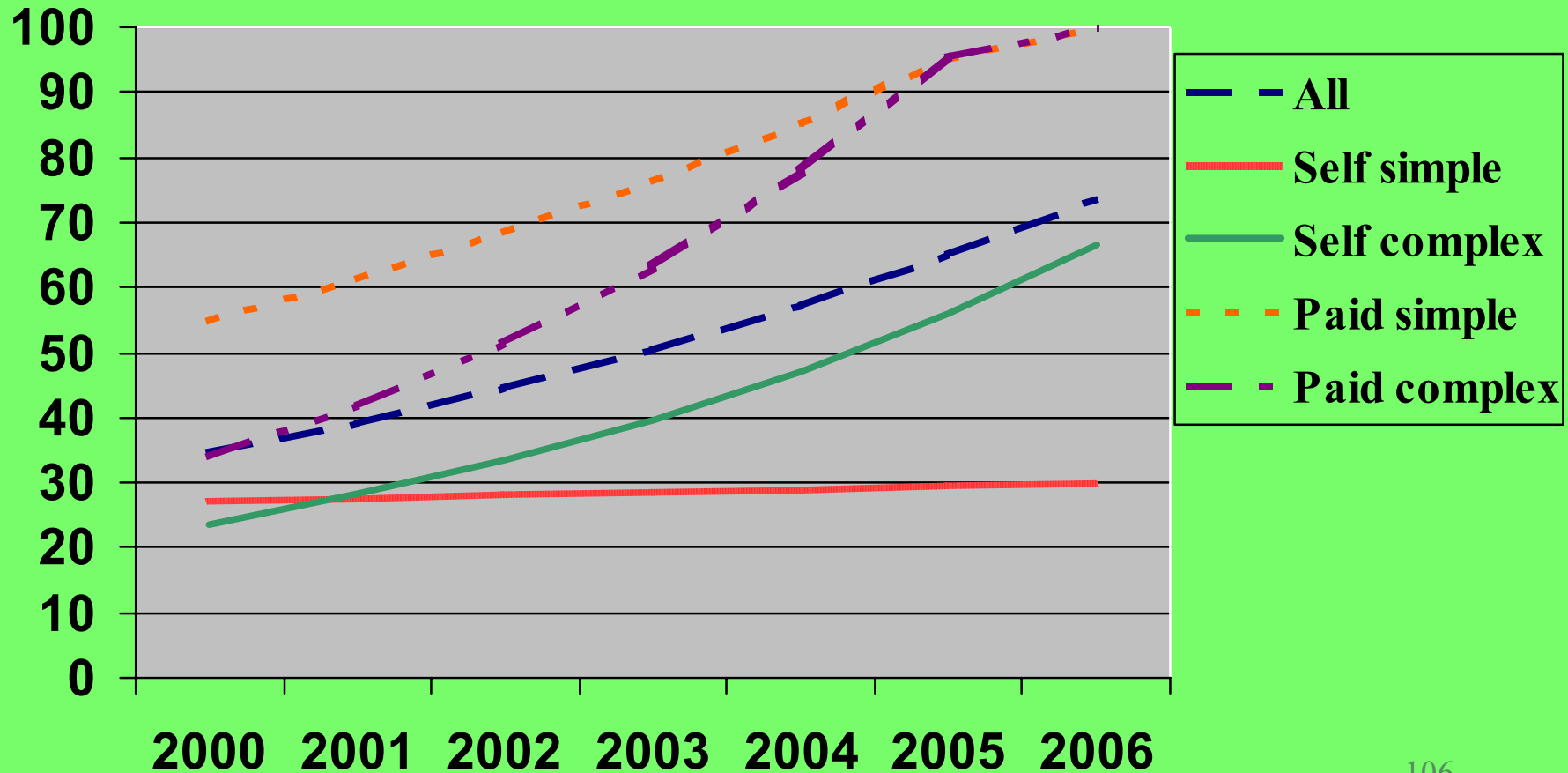
- This segment had the lowest *e-file* growth rate of all four segments.
- How can we increase electronic filing in this segment?
- *e-file* penetration is almost the same as in TY1997.

Growth in *e-file* is lagging with self-prepared simple returns:

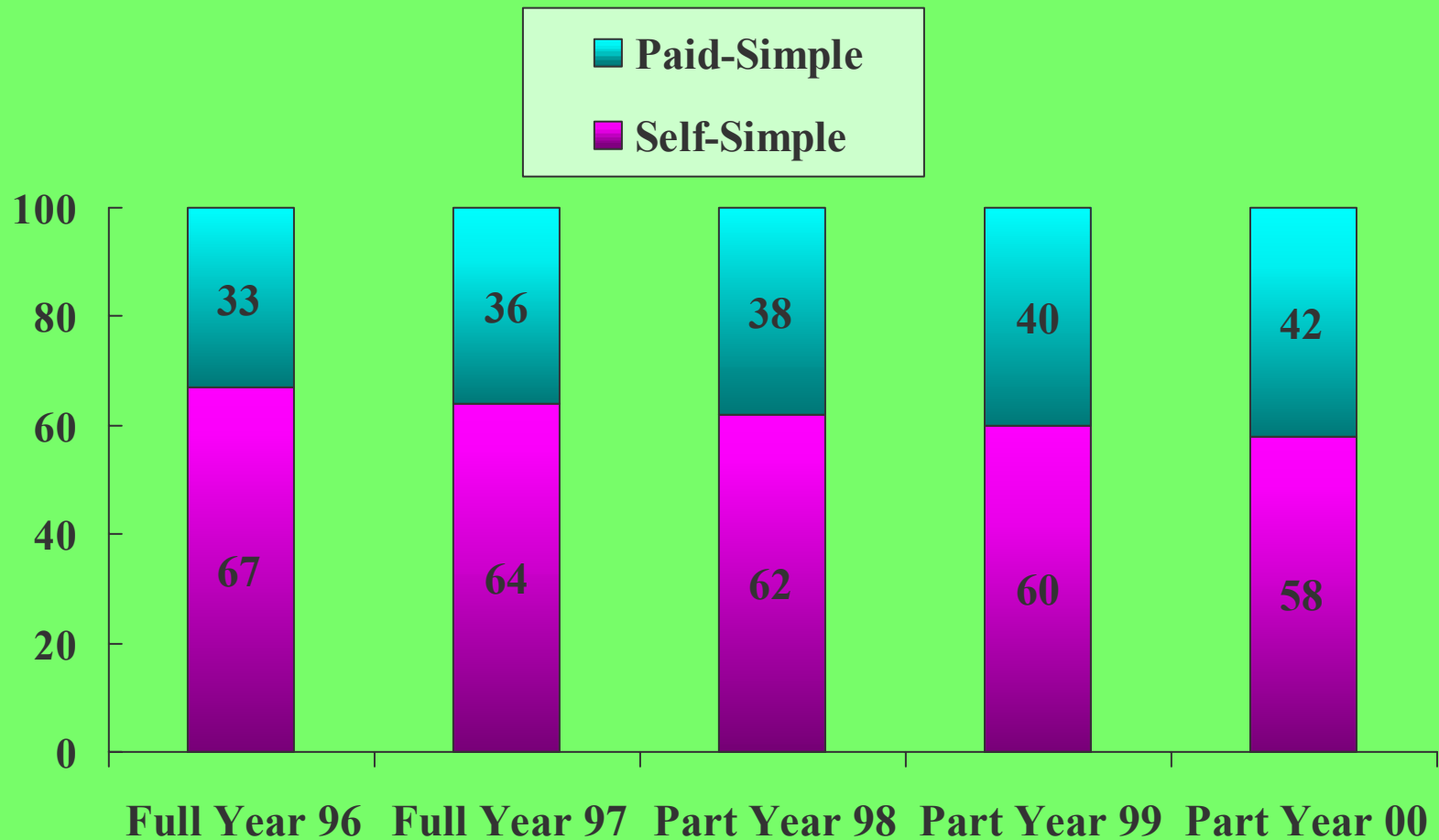
| Market segment | TY 1999 | | | TY 2000 | | | Percent growth |
|----------------|-------------|---------------|---------|-------------|---------------|---------|----------------|
| | Returns | <i>e-file</i> | Percent | Returns | <i>e-file</i> | Percent | |
| Self-simple | 32,977,585 | 8,625,267 | 26% | 32,056,921 | 8,760,032 | 27% | 4% |
| Self-complex | 20,964,857 | 4,051,771 | 19% | 20,350,265 | 4,814,195 | 24% | 26% |
| Paid-simple | 22,280,482 | 11,622,847 | 52% | 23,599,112 | 12,976,299 | 55% | 6% |
| Paid-complex | 38,821,826 | 10,851,949 | 28% | 38,936,189 | 13,321,670 | 34% | 21% |
| Total | 115,044,750 | 35,151,834 | 31% | 114,942,487 | 39,872,196 | 35% | 13% |

e-file for self-prepared simple returns has grown at less than five percent for the last few years.

Hypothetical, potential electronic growth by market segment - using TY 2000 growth:



Simple filers have been moving from self-prepared to paid-prepared returns.

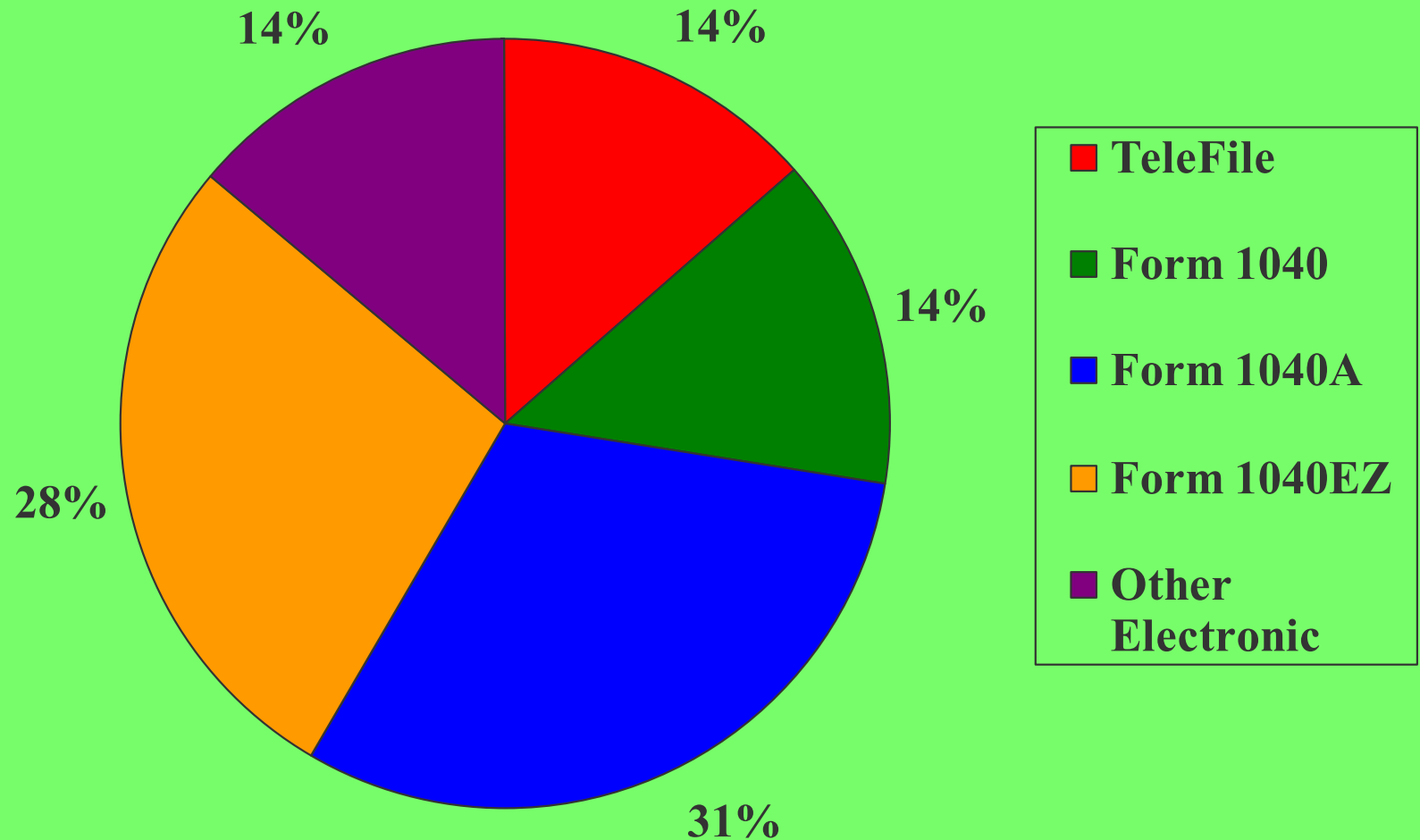


What filing method and forms did the self-prepared simple market segment filers use?

Return Filing by Self-Prepared Simple Filers

| | Self Prepared Simple Returns | |
|----------------------|-------------------------------------|-------------------|
| Filing method | Count | Percentage |
| Paper | 23,296,889 | 72.7 |
| ELF | 1,498,407 | 4.7 |
| TeleFile | 4,414,025 | 13.8 |
| On-Line | 2,847,600 | 8.9 |
| Total | 32,056,921 | 100.0 |

Forms used by the Self-prepared Simple Segment TY 2000



Form Used for Paper Returns

| Form | V-code number | V-code percentage of form type | Count | Percentage of total |
|---------------|--------------------------|---|--------------|--------------------------------|
| 1040 | 1,339,335 | 30.5 | 4,395,649 | 18.9 |
| 1040A | 1,948,836 | 19.9 | 9,796,953 | 42.1 |
| 1040EZ | 22,116 | 0.2 | 9,104,287 | 39.0 |
| Total | 3,310,287 | | 23,296,889 | 100.0 |

In the self-prepared simple market segment:

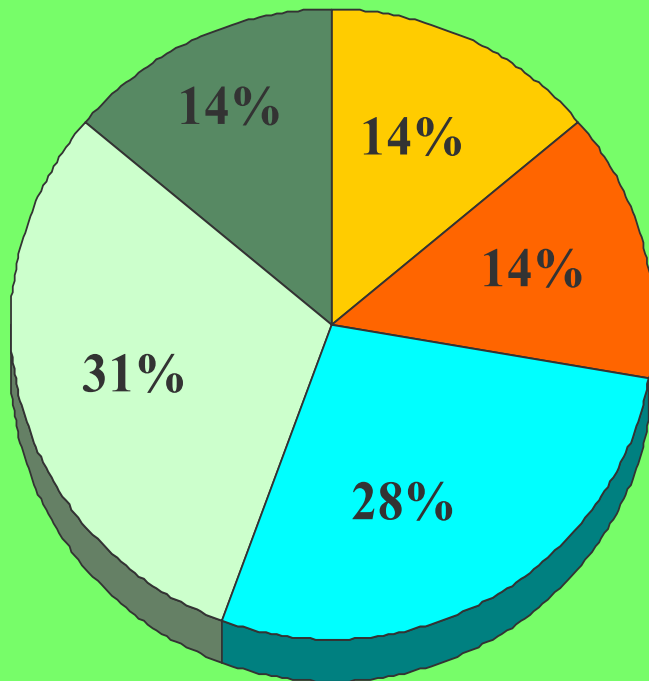
- 23% of those who filed a Form 1040 were mailed a TeleFile package
(30% are V-code)
- 15% of those who filed a Form 1040A were mailed a TeleFile package
(20% are V-code)
- 56% of those who filed a Form 1040EZ were mailed a TeleFile package
(0.2% are V-code)

The simplest forms that could have been used by paper filers:

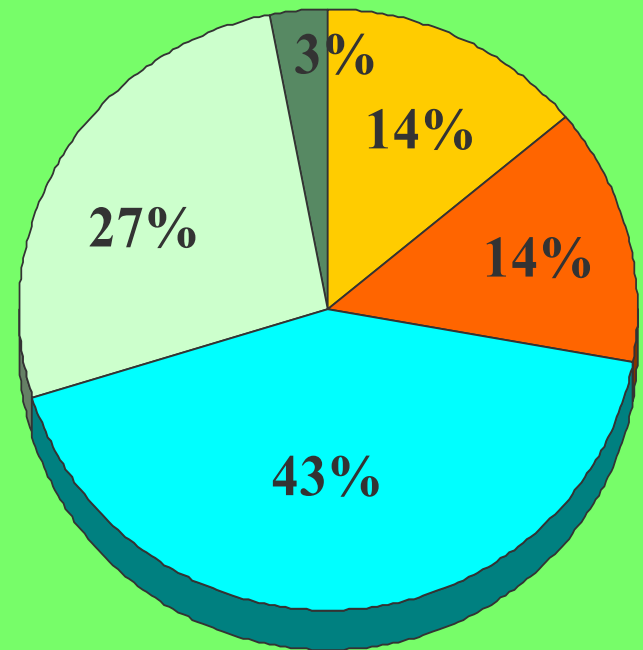
| | Self Prepared Paper Filers | |
|--------|----------------------------|------------|
| Form | Count | Percentage |
| 1040 | 808,751 | 3.5 |
| 1040A | 8,624,390 | 37.0 |
| 1040EZ | 13,863,748 | 59.5 |
| Total | 23,296,889 | 100.0 |

How returns were filed and how they could have been filed

As Filed



Simplest Form Possible



- TeleFile
- Other Elec
- 1040EZ
- 1040A
- 1040

Self-Prepared Simple Returns

Summary

- Electronic filing for self-prepared simple is 27% compared to 35% for all segments.
- About 73% of the returns in this segment are filed on paper.
- 97% could have filed using 1040EZ or 1040A; only 81% did so.
- Filers are young (49% under 30), single (69%) and lower income (46% under \$15,000 and 75% under \$30,000).

What Is the Bottom Line?



Overall Summary

- » The use of *e-file* increased, but the current growth rate is still not sufficient to reach 80% electronic filing by the year 2007. 35% of 2000 returns were filed electronically.
- » Almost 10% of returns changed BOD from 1999, but there may be a flaw in BOD code assignment.
- » First-time filers *e-filed* only 21% of time; if self-prepared first-time filer, *e-filed* only 10% of time.
- » ELF filer repeat rates for paid-preparer returns in 2000 were almost 90%.

Overall Summary (continued)

- » In each market segment *e-file* users more often are younger, single, have a refund return, claim EIC and utilize direct deposit than non-users.
- » Time-of-filing appears to be the biggest factor in the taxpayer's decision whether or not to electronically file a return.
- » The filing of computer prepared paper returns (V-code) continues to increase. 76% of all V-code returns are prepared by paid-preparers.

Overall Summary (continued)

- » Only 30% of former 1040PC filers filed electronically; over 57% filed a V-coded return.
- » If the ineligibility obstacle could be removed TeleFile users are the most loyal customers we have, but because of ineligibility they are our least loyal customers.
- » Parents' use of *e-file* strongly influences dependents' use of *e-file*.
- » Growth in *e-file* is still lagging in the self-prepared simple segment. Electronic filing for them is 27% compared to 35% for all segments.

Overall Recommendations

- For the self-prepared simple segment, modify IRS web site to allow On-Line filing for 1040EZ returns. Also helps first-time simple filers and TeleFilers. An internet based equivalent to TeleFile would not compete with private industry and would provide an electronic filing option to this segment.
- Specific marketing with a different message to taxpayers who file after April 15.

Overall Recommendations (continued)

- Modify TeleFile to eliminate moving as an obstacle (through internet based 1040EZ filing).
- Conduct research to determine the reliability of the business operating division code assignment.
- Secure and compare the dependent database to our database to better analyze the relationship between a parent and dependent's method of filing.

Final Words

- Last year our 3-year relational database became operational, but few questions from ETA have utilized multiple year data.
- Baseline questions for 2003 (TY 2001) are now being developed. Submit yours through Diane Geraghty.
- Each year the database grows in size as more more returns are filed and more data is added. W&I Research Group 5 soon will not be able to handle three years of ETA data without computer enhancements (increased storage capacity).